Chapter I:2

Determination of Tax

Discussion Questions

I:2-1 a. Gross income is income from taxable sources. Form 1040 combines the results of computations made on several separate schedules. For example, income from a sole proprietorship is reported on Schedule C, where gross income from the business is reduced by related expenses. Only the net income or loss computed on Schedule C is carried to Schedule 1 (and from there to Form 1040). This is procedurally convenient but means gross income is not shown on Form 1040.

b. Gross income is relevant to certain tax determinations. For example, whether an individual is required to file a tax return is based on his or her gross income. As the amount does not necessarily appear on any tax return, it may be necessary to separately make the computation in order to determine whether a dependent is a qualifying relative. pp. I:2-3, I:2-14, I:2-33, and I:2-34.

I:2-2 The term "income" includes all income from whatever source derived, based on principles of economics and/or accounting. Gross income refers only to income from taxable sources; it does not include tax-exempt income. p. I:2-3.

I:2-3 a. A deduction is an amount that is subtracted from gross income (or adjusted gross income), while a credit is an amount that is subtracted from the tax itself.

b. In general, a $10 credit is worth more than a $10 deduction because the credit results in a $10 tax savings. The savings from a deduction is less than 100% of $10, depending on the tax bracket that applies to the taxpayer.

c. If a refundable credit exceeds the taxpayer's tax liability, the taxpayer will receive a refund equal to the excess. In the case of nonrefundable credits, the taxpayer will not receive a refund, but may be entitled to a carryover or carryback. pp. I:2-4 through I:2-6.

I:2-4 A dependent must be a qualifying child or a qualifying relative:

- A qualifying child must:
  - Be the taxpayer's (a) child, (b) sibling, or (c) descendent of (a) or (b)
  - Be under 19, a full-time student under 24, or disabled
  - Live with the taxpayer for more than half the year, and
  - Not provide more than half of his or her own support.
- A qualifying relative must:
  - Be related to the taxpayer (or reside in the taxpayer's home for the entire year)
  - Have gross income less than $4,200 (2019), and
  - Receive more than half of his or her support from the taxpayer.

Both qualifying children and qualifying relatives also must meet several other requirements:

- Meet a citizenship test
- Cannot normally file a joint return, and
- Cannot claim others as dependents.

pp. I:2-12 through I:2-16.

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I:2-5 a. Support includes amounts spent for food, clothing, shelter, medical and dental care, education, and the like. Support does not include the value of services rendered by the taxpayer for the dependent nor does it include a scholarship received by a son or daughter of the taxpayer.

b. Maybe. There are several situations where a taxpayer provides 50% or less of another person's support and can claim that person as a dependent:

- If the other person does not provide more than half of his or her own support, that person is the taxpayer's qualifying child (if the other tests for a qualifying child are met).
- When several individuals contribute to the support of another, it is possible for members of the group to sign a multiple support agreement that enables one member of the group to claim the supported person as a qualifying relative.
- In the case of divorced couples, the parent with custody for over half of the year may claim their child as a dependent. Similarly, in the case of a written agreement, the noncustodial parent may claim their child as a dependent.

c. The value of an automobile given to an individual may represent support for that individual. The automobile must be given to the individual and must be used exclusively by the individual. pp. I:2-13 and I:2-15.

I:2-6 A taxpayer will use a tax rate schedule instead of a tax table if taxable income exceeds the maximum in the tax table (currently $100,000) or if the taxpayer is using a special tax computation method such as short-year computation. p. I:2-19.

I:2-7 a. In general, it is an individual's gross income that determines whether he or she must file a return. The specific dollar amounts are listed in the text. Certain individuals must file even if they have less than the specified gross income amounts: (1) dependent individuals whose unearned income exceeds $1,100 or whose total gross income exceeds the standard deduction, (2) taxpayers who owe the 0.9% Additional Medicare Tax or the 3.8% Net Investment Income Tax, and (3) taxpayers with $400 or more of net self-employment income.

b. Individuals who owe no tax because of deductions or other reasons must still file a return if they have gross income in excess of the filing requirement amounts. p. I:2-33 and I:2-34.

I:2-8 Home mortgage interest and real property taxes are itemized deductions. As a result, a homeowner's itemized deductions often exceed the standard deduction, making it beneficial to itemize. Renters typically do not have these deductions, so the standard deduction often is greater than itemized deductions. p. I:2-11.

I:2-9 If the support test for a qualifying relative were "50% or more" and two individuals each provided exactly 50% of another person's support, that person would be a qualifying relative of both individuals (assuming the other requirements for a qualifying relative were met). By specifying that the individual provides "more than 50%" of the person's support, that person cannot be a qualifying relative of more than one individual. If two individuals each provide exactly 50% of another person's support, that person would not be a qualifying relative of anyone because no one provided more than half of his or her support, but the two individuals may be able to use a multiple support agreement to allow one of them to claim that other person as a dependent.

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In practice, it is unlikely that an individual provides exactly 50% of another person's support. The distinction between "50% or more" and "more than 50%" is important, however, in other areas of the tax law. For example, consider an individual who owns exactly 50% of a corporation's stock, and that individual sells all of his or her stock to the person who owns the other 50% of the corporation's stock. As Chapter C:7 discusses, the deductibility of a corporation's net operating loss is limited if the corporation's ownership changes by more than 50 percentage points. In this case, that limitation would not be triggered because the corporation's ownership changes by exactly 50 percentage points, not more than 50 percentage points. p. I:2-15.

I:2-10 The normal due date for calendar-year individuals and C corporations is April 15. The normal due date for calendar-year partnerships and S corporations is March 15. If the normal due date is a Saturday, Sunday, or holiday, the normal due date is delayed to the next day that is not a Saturday, Sunday or holiday. p. I:2-34.

I:2-11 Automatic extensions of six months generally are available. For a C corporation, the extension is six or seven months, depending on fiscal year-end. Any tax that may be owed must be paid with the application for an extension. p. I:2-34.

I:2-12 Yes. In general, the source of income is not important. It is the use that is important. An exception does exist for a child's scholarship. Parents do not have to consider a child's scholarship when determining whether they provide over half of the child's support (or whether the child provided more than half of his or her own support). p. I:2-15.

I:2-13 Scholarships generally do qualify as support, but an exception exists for a scholarship received by the taxpayer's child. Parents may ignore a child's scholarship in determining whether they provide over half of the child's support (or whether the child provided more than half of his or her own support). p.I:2-15.

I:2-14 The purpose of the multiple support agreement is to allow one member of a group to claim a supported person as a qualifying relative when the members together contribute more than 50% of the support of that person and each member of the group contributes over 10% (the group includes only those individuals contributing over 10% of the supported person's support and who meet the relationship test for a qualifying relative with respect to the supported person). The multiple support agreement results in an exception to the requirement that the taxpayer alone must provide over one-half of the qualifying relative's support. pp. I:2-16 and I:2-17.

I:2-15 In general, the parent with custody for the greater part of the year may claim the children as dependents. The noncustodial parent may claim them as dependents only if required documentation provides for it. p. I:2-18.

I:2-16 In general, a couple must be married on the last day of the tax year in order to file a joint return. In addition, the spouses must have the same tax year. Also, if one spouse is a nonresident alien, then that spouse must agree to include all of his or her gross income on the return. p. I:2-20.

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I:2-17 The phrase "maintain a household" means to pay over one-half of the costs of the household. These costs include property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance and food consumed on the premises. Such costs do not include clothing, education, medical treatment, vacations, life insurance and transportation. p. I:2-22.

I:2-18 A married person, if otherwise qualified, can claim head-of-household status if he or she is married to a nonresident alien or if he or she qualifies as an abandoned spouse. To be an abandoned spouse, the taxpayer must have lived apart from his or her spouse for the last six months of the year and maintain a household for a qualifying child in which they both live. p. I:2-23.

I:2-19 a. A C Corporation is taxed on its income. In other words, it is taxed as a separate entity. An S Corporation is normally not taxed on its income. Instead, its shareholders report the S corporation's income on their own income tax returns. That is, the shareholders (not the corporation) are taxed on the corporation's income. This flow-through treatment occurs even if the income is not actually distributed.

b. Some corporations are ineligible for making an S corporation election. Others may choose the C corporation because the 21% corporate tax rate is less than the rate for the higher individual tax brackets (e.g., 32%, 35%, and 37%). Other considerations not discussed in Chapter 2 include fringe benefits, the need to retain earnings in the business and dividend policy. pp. I:2-27 and I:2-28.

I:2-20 The 21% tax rate that applies for C corporations. If an individual with a significant amount of other income operates a new business as a sole proprietorship, that income is taxed at the owner's marginal tax rate, which may be higher than 21%. Thus, the current tax can be reduced if the corporate form is used and income is retained in the corporation. This advantage will be reduced (and possibly reversed) if the corporation distributes the income. New businesses often need to retain income for expansion. p. I:2-27.

I:2-21 a. The major categories of property excluded from capital asset status are:

- Inventory
- Trade receivables, such as accounts receivable
- Certain properties created by the efforts of the taxpayer
- Depreciable business property and business land
- Certain government publications.

b. Yes. An individual's net long-term capital gain generally is taxed at 0%, 15%, or 20%, depending on the taxable income and filing status. These tax rates are less than the rates that otherwise would apply. Short-term capital gains are taxed much like other income.

c. The availability of favorable tax rates for long-term gains is one implication of capital asset classification. Another is the limitation on the amount of capital loss that can be deducted from other income. At the present time, only $3,000 of net capital loss can be deducted from other income by an individual taxpayer in any year.

d. Individual taxpayers first deduct (or offset) capital losses from capital gains. If a net capital loss results, only $3,000 of the net capital loss can be deducted from other income. Net capital losses in excess of $3,000 are carried over to future years. p. I:2-30.

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I:2-22 Yes. By waiting, the taxpayer can convert the short-term gain to a long-term gain taxed at a lower rate. The long-term rate will be available if the taxpayer holds the property over 12 months. The taxpayer should, however, take into consideration other nontax factors, such as whether the value of the asset may decline during the extended holding period. p. I:2-30.

I:2-23 a. Shifting income means moving income from one tax return to another. Splitting income means creating additional taxable entities (such as C corporations) so as to spread income between more taxpayers.

b. Different taxpayers are in different tax brackets. As a result, taxes can be saved by shifting income from a taxpayer who is in a high tax bracket to a taxpayer who is in a lower tax bracket.

c. The tax on the unearned income of children (i.e., the kiddie tax) was created to reduce the opportunity to reduce taxes by shifting income from parents who are in high tax brackets to children who have little or no other income and would, therefore, normally be in a low tax bracket. pp. I:2-30 and I:2-31.

I:2-24 a. Both spouses are liable for additional taxes on a joint return. An exception exists for a so-called innocent spouse. To utilize the innocent spouse provision, the tax must be attributable to erroneous items of the other spouse. In addition, the innocent spouse cannot have known or had reason to know of the error, and must elect relief within two years after the IRS begins collection activities. Further, it must be inequitable to hold the innocent spouse liable for the understatement.

b. In the event of underpayment of taxes on a joint return, the IRS can collect the unpaid tax from either spouse. pp. I:2-32 and I:2-33.

I:2-25 Couples may change from joint returns to separate returns only prior to the due date for the return. Couples may change from separate returns to a joint return within three years of the due date including extensions. p. I:2-33.

Issue Identification Questions

I:2-26 The main issue is whether Yung can claim his nephew as a dependent. The nephew must be a U.S. citizen or U.S. resident in order to qualify. The nephew is not a U.S. citizen, so he must be a U.S. resident to qualify as a Yung’s dependent. Normally, this requires that a person have a visa as a permanent resident, but dependency has been permitted when special circumstances were present. For example, the Tax Court allowed a foreigner to be claimed as a dependent when it considered the length of the dependent's stay, the individual's intent, and the presence of substantial assets in the U.S. [Carmen R. Escobar, 68 TC 304 (1977)]. The nephew's desire to stay and the desire of other members of the family to move here could all be factors that are considered in determining whether the nephew is a resident. p. I:2-13.

I:2-27 The primary tax issue is whether they should file a joint return. Filing jointly could produce a tax savings because more income will be taxed at a 10% rather than 12% rate. Carmen, however, should carefully consider whether Carlos is disclosing all of his income. If not, she may be liable for additional taxes, interest, and penalties resulting from the unreported income. The innocent spouse rules may not protect her. She is not required to know with certainty Carlos' income in

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order to be liable. The fact that Carmen is "surprised" that Carlos' income is so low suggests that she has reason to know that there is unreported income. pp. I:2-32 and I:2-33.

I:2-28 The primary tax issue is the filing status for both Bill and Jane. Both can file as unmarried taxpayers because they were divorced prior to the end of the tax year, assuming neither one has remarried. To file as a head of household, a taxpayer must pay more than one-half of the costs of maintaining a household (as one's home) in which a dependent relative lives for more than one-half of the year. In the case of divorce, the child need not be a dependent of the custodial spouse. The facts in this question are similar to W.E. Grace v. CIR, 25 AFTR 2d 70-328, 70-1 USTC ¶ 9149 (5th Cir., 1970) and Levon P. Biolchin v. CIR, 26 AFTR 2d 70-5727, 70-2 USTC ¶ 9674 (7th Cir., 1970) where the courts disregarded the fact that the taxpayer owned the house and denied head of household status. Jane should also fail to qualify for head of household status because she did not pay more than one-half of the costs of maintaining the household. Secondary issues concern the treatment of child support payments and whether the furnishing of home expenses can be treated as alimony. p. I:2-22.

Problems

I:2-29

	Smiths	Millers
Salary	$30,000	$95,000
Taxable interest income	20	1,000
Gross Income	$30,020	$96,000
Minus: IRA Contribution	0	(6,000)
Adjusted gross income	$30,020	$90,000
Minus: Greater of standard deduction or itemized deductions	(24,400)	(26,400)
Taxable Income	$ 5,620	$63,600
Gross tax (using Rate Schedule)	$ 562*	$ 7,244*
Minus: Withholding	(750)	(8,500)
Tax due (refund)	($ 188)	($ 1,256)

* This answer is based on the 2019 rate schedule. The 2019 tax table was unavailable at the time this solution was prepared. The actual answer using the tax table would be very close to the above answer. pp. I:2-6, I:2-7, and I:2-10.

I:2-30 a.

Salary	$ 7,000
Taxable interest income	425
Adjusted gross income	$ 7,425
Minus: Standard deduction	(12,200)
Taxable income	-0-

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b.

Salary	$ 7,000
Taxable interest income	425
Adjusted gross income	$ 7,425
Minus: Standard deduction	(7,350)*
Taxable income	$ 75

*$12,200 standard deduction is limited to the greater of $7,350 ($7,000 earned income plus $350) or $1,100.

p. I:2-12.

I:2-31 a.

	Carl	Carol
Adjusted gross income	$60,000	$90,000
Minus: Itemized deductions	(11,000)	(16,200)
Taxable income	$49,000	$73,800

Note: Because Carol claimed itemized deductions on her return, Carl must also itemize. Their total itemized deductions are $27,200 ($11,000 + $16,200). Both could have claimed a standard deduction of $12,200 (total of $24,400), so they gained $2,800 ($27,200 - $24,400) of deductions by itemizing.

b.

Adjusted gross income ($60,000 + $90,000)	$150,000
Minus: Itemized deductions ($11,000 + $16,200)	(27,200)
Taxable income	$122,800

Note that this $122,800 taxable income equals the sum of their $49,000 and $73,800 taxable incomes if they file separately.

p. I:2-11.

I:2-32 The person is not Wes and Tina's dependent in parts a, b, and d but is their dependent in parts c and e.

a. Brian is not a qualifying child because he fails the age test (he is over age 23). Brian is not a qualifying relative because he fails the gross income test (his gross income of $5,200 is not less than $4,200 for 2019).

b. No effect. Brian's student status is irrelevant because he is over age 23. Thus, Brian is not a qualifying child or a qualifying relative.

c. Sherry meets the four requirements to be a qualifying child: (1) she meets the relationship test because she is Wes and Tina's child, (2) she meets the age test because she is under age 24 and a full-time student, (3) she meets the abode test because her principal place of abode is with her parents for more than half the year; her temporary presence in the dormitory for her college education is treated as time living with her parents, and (4) she does not provide more than half of her own support because her parents provide more than half. Sherry's gross income is relevant for determining if she is her parent's qualifying relative, but she meets the criteria to be a qualifying child.

d. Sherry is not a qualifying child because she fails the age test (she is not under 24 *and* a full-time student). Sherry is not a qualifying relative because she fails the gross income test (her

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gross income of $5,000 is not less than $4,200 for 2019). Although the parents meet the relationship test and support test with respect to Sherry, they must meet all three tests for her to be their qualifying relative.

e. Granny is not a qualifying child because she fails the age test (she also fails the relationship test for a qualifying child). However, Granny meets all the requirements to be a qualifying relative of Wes and Tina: (1) she meets the relationship test because she is an ancestor of Tina, (2) she meets the gross income test because her gross income is zero (her only income, the Social Security, is wholly tax-exempt), and she meets the support test because Wes and Tina provide 60% of her support.

pp. I:2-12 through I:2-15.

I:2-33 a. Carole and John can claim David and Kristen as dependents this year (David and Kristen are their qualifying children). Jack is not a qualifying child (over age 18 and not a full-time student) and is not a qualifying relative because his gross income is not less than $4,200. David meets the requirements to be a qualifying child: (1) he meets the relationship test because he is Carole and John's child, (2) he meets the age test because he is under age 24 and a full-time student, (3) he meets the abode test because he lives with Carole and John for more than half the year, and (4) he meets the support test because he does not provide more than half of his own support. The fact that David's $6,400 gross income is not less than $4,200 is irrelevant; it is relevant for determining whether he is a qualifying relative. Kristen also meets the requirements to be a qualifying child.

b. Jack is Carole and John's qualifying child because he meets the age test (Jack is under age 24 and a full-time student for at least five months this year). Carole and John can claim Jack, David, and Kristen as dependents. Note that Jack will not be Carole and John's qualifying child next year because he will be age 24, not under age 24 (although Jack may be their qualifying relative next year).

c. As in part a, Jack is not a qualifying child because he fails the age test. However, he meets the requirements to be Carole and David's qualifying relative: (1) he meets the relationship test because he is their child, (2) he meets the gross income test because his $3,000 gross income is less than $4,200, and (3) he meets the support test because John and Carole provide more than half of Jack's support.

d. David would not be a qualifying child because he would fail the age test (he is not under age 24 *and* a full-time student). David also would not be a qualifying relative because he fails the gross income test (his $6,400 gross income is not less than $4,200).

e. David would not be a qualifying child because he would fail the support test (he would provide more than half of his own support). David also would not be a qualifying relative because he would fail the support test for a qualifying relative (John and Carole would not provide more than half of David's support). pp. I:2-12 through I:2-15.

I:2-34 a. No. Jane is not a qualifying child because she fails the age test (she is not under age 19 and is not under age 24). Jane also fails the abode test because she does not live with Robert for more than half the year. Jane is not a qualifying relative because her $20,000 gross income is not less than $4,200.

b. Yes. The children meet the requirements to be Jane's qualifying children: (1) they meet the relationship test because they are Jane's children, (2) they meet the age test because they

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are under age 19, (3) they meet the abode test because they live with Jane for more than half the year, and (4) they each meet the support test because Robert, not themselves, provides more than half of their support. The children are not Robert's qualifying relatives because they are Jane's qualifying children.

c. Jane is entitled to the $2,000 child credit for each of her two children because they are her qualifying children and are under age 17. Assuming Jane claims the standard deduction, her taxable income is $7,800 ($20,000 - $12,200) and her tax before credits is $780 ($7,800 x 0.10). The refundability of Jane's child credit is limited to the lesser of $2,625 ((0.15 x ($20,000 - $2,500)) or $2,800 ($1,400 x 2), so she can use $780 of the $4,000 ($2,000 x 2) credit to offset her $780 tax before credits and another $2,625 as a refundable credit. Jane will be unable to use the last $595 ($4,000 - $780 - $2,625) of the credit. pp. I:2-12 through I:2-15, p. I:2-18, and p. I:2-19.

I:2-35 Based on the facts given, Juan cannot claim either Maria or Norma as dependents. He can claim Jose as a dependent only if written documentation exists.

Maria provides $12,000 of her own support, and Juan provides $9,000 ($5,000 + $4,000) of it. Juan thus does not provide more than half of Maria's support, so the support test for a qualifying relative is failed. The support test for a qualifying child is also failed, as well as the age test for a qualifying child.

Jose generally would be Linda's qualifying child because she is Jose's custodial parent. If Linda signs a completed Form 8332, Juan can claim Jose as a dependent.

Norma is not a qualifying child because she fails the age test (she is not under age 24 *and* a full-time student). Norma also fails the abode test with respect to Juan because she does not live with him for more than half the year (she also fails the abode test with respect to her father). Norma is not a qualifying relative because her $6,000 gross income is not less than $4,200. pp. I:2-12 through I:2-15 and p. I:2-18.

I:2-36 a. Mario and Elaine. To be eligible to claim Anna as a qualifying relative under a multiple support agreement, an individual must:

- Provide more than 10% of the supported person's support. In Anna's case, Mario, Caroline, and Elaine provide more than $700 (0.10 x $7,000) of Anna's support.
- Meet all requirements, other than the support requirement, for claiming Anna as a qualifying relative. Anna meets the relationship test for a qualifying relative with respect to Mario, Doug, and Elaine, and she meets the gross income test because her zero gross income is less than $4,200.

Only Mario and Elaine meet both criteria, so only they are eligible to claim Anna as a qualifying relative under a multiple support agreement.

b. Elaine. That is, all other individuals who are eligible to claim Anna as a qualifying relative under a multiple support agreement.

c. $12,200. Mario is not married and presumably is not a surviving spouse. Head-of-household status cannot be based on dependency obtained as the result of a multiple support agreement. Mario is not eligible for an additional standard deduction due to age. Although his dependent mother is age 65 or older, Mario is not. pp. I:2-14 through I:2-17.

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I:2-37 a. Joan, the custodial spouse, claims the children as dependents and receives the child credit for them.

b. No. p. I:2-18.

I:2-38 a. Schedule 3 because of the child care credit Abby and Bert claim.

b. None. Form 1040 reports all of the information Celeste needs to report.

c. Schedule 1. The long-term capital gain carries to Schedule 1 from Schedule D (and may carry to Schedule D from Form 8949). Donna and Ernie also file Schedule A to claim their itemized deductions.

d. Schedule 5 because of the estimated tax payments. Fiona also files Schedule B to report the taxable interest income and Form 8615 for her kiddie tax.

pp. I:2-35 and I:2-36.

I:2-39 a. Zero dependents and zero credit. A cousin does not meet the relationship test for a qualifying child and meets the relationship test for a qualifying relative only if the cousin lives with the taxpayer for the entire year.

b. One dependent and $500 credit. Bob's father is a qualifying relative. The gross income test is met because the father's gross income of $800 is less than $4,200. The abode test must be met for a qualifying child but not for a qualifying relative. Bob and Ann are allowed a $500 credit for the father because he is their dependent but is not a qualifying child under age 17.

c. One dependent and $500 credit. The daughter is a qualifying child. Although the gross income test must be met for a qualifying relative, it does not have to be met for a qualifying child. Clay is allowed a $500 credit; although the daughter is a qualifying child, she is not under age 17.

d. Zero dependents and zero credit. The multiple support agreement is irrelevant because the mother provided over half of her own support.

e. Two dependents and $2,500 credit. The daughter is a qualifying child; the gross income test need not be met. The son is also a qualifying child. Zoe and Walt are allowed a $2,000 child credit for their son because he is a qualifying child under age 17, but they are allowed only a $500 credit for their daughter because she is not under age 17. pp. I:2-12 through I:2-19.

I:2-40 a. Juan's AGI exceeds $200,000, but Maria's AGI does not. The child credit thus would be reduced if Juan claims it, but there would be no reduction if Maria claims it. Overall, the tax savings are larger if Maria claims the child credit, so it would be better not to have a written agreement allowing Juan to claim the children as dependents. However, Juan may not be willing to pay as much child support if he foregoes any child credit.

b. As the custodial parent, Maria is entitled to file as a head-of-household. This is true even if she does not claim the children as dependents. Juan will file as a single taxpayer. pp. I:2-18 and I:2-19.

I:2-41 a.

Adjusted gross income ($105,000 + $86,000)	$191,000
Minus: Itemized deductions ($19,000 + $8,100)	(27,100)
Taxable income	$163,900
Gross tax	$ 27,775

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b. Mary's tax filing as a single taxpayer:

Adjusted gross income	$86,000
Minus: Standard deduction	(12,200)
Taxable income	$73,800
Gross tax	$12,095*

Bill's tax filing as a single taxpayer:

Adjusted gross income	$105,000
Minus: Itemized deductions	(19,000)
Taxable income	$ 86,000
Gross tax	$ 14,815*

Their income taxes total $26,910 ($12,095 + $14,815).

*These amounts are based upon the 2019 tax rate schedule because the 2019 tax table was unavailable when the solution was prepared.

c. Their tax will be $865 ($27,775 - $26,910) higher if they marry before year-end. This is attributable to the fact that their $27,100 of itemized deductions is $4,100 less than the $31,200 ($12,200 + $19,000) of total deductions they would claim if they were not married. The increased taxes due to this is partially offset by the fact that $1,800 ($86,000 - $84,200) of Bill's taxable income is taxed at 22% if they are married rather than 24% if they are not. pp. I:2-20 and I:2-21.

I:2-42 a. Amy need not file because her gross income is less than the threshold of $12,200 and her self-employment income is less than $400.

b. Betty need not file, as her gross income ($9,100) is less than $13,850 ($12,200 + $1,650).

c. Chris must file, as his gross income of $2,300 exceeds his standard deduction of $2,250 ($1,900 + $350). Chris' standard deduction is limited to the amount of earned income plus $350 (or $1,100, if greater).

d. Dawn must file because her unearned income is over $1,100 and her total gross income exceeds her standard deduction.

e. Doug must file because his gross income is over $5 and he is married and not living with his spouse. p. I:2-33 and I:2-34.

I:2-43 a. Yes.

b. No. The aunt does not live with the taxpayer for more than half the year.

c. No. Cindy qualifies as a surviving spouse, so she does not qualify as a head of household. This is beneficial for Cindy because, as a surviving spouse, she is allowed a larger standard deduction than as a head of household, and the tax rate schedule is also more favorable.

d. Yes. Because Dick qualifies as an abandoned spouse, he can file as a head-of-household. pp. I:2-22 and I:2-23.

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I:2-44 a. 2017: Celia files a joint return even though Wayne died in October.

2018: Celia must file as a single taxpayer. As a part-time student, Wally is not a qualifying child. Celia thus does not qualify as a head of household because she does not maintain a household in which a dependent lives for more than half the year.

2019: Same as 2018.

2020: Same as 2018.

b. Single. Juanita does not qualify for head-of-household status because Josh is not a qualifying child. He is over 18 and is not a full-time student.

c. Gertrude may use the head-of-household filing status. Even though she is still legally married, she meets the tests for an abandoned spouse. She lived apart from her spouse for the last six months of the taxable year and paid over one-half the cost of maintaining a household for her dependent son. pp. I:2-21 through I:2-23.

Note to Instructor: A good exercise is to ask the class how the solution for part a would change if Wally were a full-time student rather than part-time. Celia would qualify as a surviving spouse in 2018 and 2019 and a single taxpayer in 2020.

I:2-45

Jim's salary	$ 92,000
Revenues for Pat's sole proprietorship	98,000
Gross income	$190,000
Minus: Expenses for Pat's sole proprietorship	(48,000)
IRA contributions (2 x $6,000)	(12,000)
Adjusted gross income	$130,000
Minus: Itemized deductions	(26,000)
Qualified business income deduction	(10,000)[a]
Taxable income	$ 94,000
Gross tax	$ 12,397[b]
Minus: Child credit	(2,000)
Net tax	$ 10,397
Minus: Withholdings	(7,000)
Estimated tax payments	(3,000)
Additional tax due (refund)	$ 397

[a] 0.20 x ($98,000 - $48,000).

[b] $9,086 + [0.22 x ($94,000 - 78,950)]. This is based on the 2019 tax rate schedule because the 2019 tax table was unavailable when the solution was prepared.
pp. I:2-2 through I:2-7 and I:2-18.

I:2-46 Jan should take the standard deduction. Jan cannot deduct any medical expenses as they are less than 10% of AGI. She is left with $5,000 of itemized deductions (mortgage interest of

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$3,000 and property taxes of $2,000) which are less than the $12,200 standard deduction. p. I:2-10.

I:2-47

Wages	$ 9,000
Interest	10,400
Adjusted gross income	$19,400
Standard deduction	(9,350)*
Taxable income	$10,050

*Because she is a dependent, Lucy's standard deduction is limited to the greater of $9,350 ($9,000 earned income plus $350) or $1,100.

Lucy is under age 18, so she is subject to the kiddie tax. Her tax is calculated as follows:

Net unearned income = $10,400 - $1,100 - $1,100 = $8,200

Earned taxable income = $10,050 - $8,200 = $1,850

A 10% tax rate applies to the first $4,450 ($1,850 + $2,600) of Lucy's taxable income, and a 24% tax rate applies to her taxable income exceeding $4,450 but not exceeding $11,150 ($1,850 + $9,300). Lucy's tax is $1,789:

10% tax rate: 0.10 x $4,450	$ 445
24% tax rate: 0.24 x ($10,050 - $4,450)	1,344
	$1,789

pp. I:2-24 through I:2-26.

I:2-48

Salaries	$130,000
Allowable capital loss	(3,000)
Adjusted gross income	$127,000
Standard deduction	(24,400)[a]
Taxable income	$102,600
Gross tax	$14,289
Child credit ((2 x $2,000) + (1 x $500))	(4,500)
Net tax	$ 9,789
Withholdings	(11,000)
Additional tax due (refund)	$(1,211)

[a] John and Georgia claim the standard deduction because it is greater than their itemized deductions of $21,800 ($10,000 + $4,000 + $2,800 + $5,000). None of the medical expenses are deductible because they are less than $12,700 (0.10 x $127,000).
[b] $9,086 + [0.22 x ($102,600 - $78,950)]

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I:2-49

Karen

Karen's gross tax is $245. At age 21, Karen is subject to the kiddie tax because she is a full-time student whose earned income is less than one-half of her own support and who has unearned income in excess of $2,200.

Taxable income:	
Wages	$3,000
Interest	2,800
Adjusted gross income	$5,800
Standard deduction ($3,000 + $350)	(3,350)
Taxable income	$2,450

Net unearned income = $2,800 - $1,100 - $1,100 = $600

Earned taxable income = $2,450 - $600 = $1,850

A 10% tax rate applies to the first $4,450 ($1,850 + $2,600) of Kim's taxable income. Because her $2,450 taxable income is less than $4,450, Kim's tax is $245 (10% x $2,450).

Susan

Susan's gross tax is $205. She is not subject to the kiddie tax as she is age 18 and her earned income is greater than one-half of her support.

Wages	$11,000
Interest	2,400
Adjusted gross income	$13,400
Standard deduction ($11,000 + $350)	(11,350)
Taxable income	$2,050
Gross tax	$ 205

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Amelie
Amelie's gross tax is $195. Amelie is subject to the kiddie tax as she is under age 18 and her unearned income is greater than $2,200.

Taxable income:	
Wages	$5,900
Interest	2,300
Adjusted gross income	$8,200
Standard deduction ($5,900 + $350)	(6,250)
Taxable income	$1,950

Net unearned income = $2,300 - $1,100 - $1,100 = $100

Earned taxable income = $1,950 - $100 = $1,850

A 10% tax rate applies to the first $4,450 ($1,850 + $2,600) of Amelie's taxable income. Because her $1,950 taxable income is less than $4,450, Amelie's tax is $195 (10% x $1,950).

I:2-50 a.

Salary	$ 70,000
S corporation income	30,000
Adjusted gross income	$100,000
Itemized deductions	(18,000)
Qualified business income deduction	(6,000)*
Taxable income	$ 76,000
Gross tax	$ 12,579

*0.20 x $30,000.

b.

Corporation:	
Taxable income	$ 30,000
Gross tax (0.21 x $30,000)	$ 6,300

Individual:	
Salary	$ 70,000
Dividend ($30,000 - $6,300)	23,700
Adjusted gross income	$ 93,700
Itemized deductions	(18,000)
Qualified business income deduction	-0-
Taxable income	$ 75,700
Gross tax	$ 10,854*
Total tax ($6,300 + $10,854)	$ 17,154

*Georgia's gross tax is the total of the tax on the dividend income and the tax on the remaining income. The tax on the dividend income of $23,700 is $3,555 (0.15 x $23,700). The tax on the remaining income of $52,000 ($75,700 - $23,700) is $7,299, computed using the rate schedule for single taxpayers.

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c. The answer to part a is unchanged as the shareholder is taxed on the S corporation's income regardless of whether it is distributed. In part b, the corporation's tax is the same, $6,300, but the shareholder is only taxed on the salary of $70,000:

Adjusted gross income	$ 70,000
Itemized deductions	(18,000)
Qualified business income deduction	-0-
Taxable income	$ 52,000
Gross tax	$ 7,299
Total tax ($6,300 + $7,299)	$ 13,599

The shareholder will be taxed on the corporation's undistributed income if it is paid out as a dividend in a future year.

pp. I:2-27 through I:2-29.

I:2-51 Before considering any reduction due to her AGI, Lana's child credit is $6,000 (3 x $2,000). For unmarried individuals, the threshold for reducing the child credit is $200,000. Lana's AGI is $204,400, so there are five $50 reductions in her credit (($204,400 - $200,000) / $1,000 = 4.4, which is four $1,000s of AGI exceeding $200,000 plus a fraction thereof). Lana's child credit is $5,750 [$6,000 - ($50 x 5)]. pp. I:2-18 and I:2-19.

I:2-52 a. They will save $1,110 ($3,000 x 0.37). Only $3,000 of loss can be offset against other income. The remaining $12,000 of loss carries over and can offset future income.

b. The additional tax is $2,000 ($10,000 x 0.20).

c. They will save $1,110 as in part a. The net loss is $5,000 but as in part a, only $3,000 can be offset against other income. The carryover, however, is only $2,000 ($15,000 - $10,000 - $3,000). They also will not have to pay any tax in the future on the $10,000 gain because they reported the gain in the current year. p. I:2-30.

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I:2-53

		2019	2020
a.	Salary	$90,000	$90,000
	Minus: Itemized or standard deduction	(12,200)	(15,800)
	Taxable income	$77,800	$74,200
	Gross Tax	$12,975	$12,183
b.	Salary	$90,000	$90,000
	Minus: Itemized or standard deduction	(12,200)	(12,200)
	Taxable income	$77,800	$77,800
	Gross tax	$12,975	$12,975
c.	Salary	$90,000	$90,000
	Minus: Itemized or standard deduction	(12,200)	(19,800)
	Taxable income	$77,800	$70,200
	Gross tax	$12,975	$11,303

d. By contributing the $8,000 in 2020, Virginia is able to deduct the entire amount. If $4,000 is contributed in each year, only the $4,000 contributed in 2020 is deductible. No tax benefit is received in 2019 because the contribution is less than the standard deduction. If $8,000 is contributed in 2019, then no tax benefit is received. pp. I:2-31 and I:2-32.

I:2-54 a. Maria's adjusted gross income is $48,000.

Salary	$51,000
Capital loss allowable	(3,000)
Adjusted gross income	$48,000

b. Maria's taxable income is $35,800.

Adjusted gross income	$48,000
Standard deduction	(12,200)
Taxable income	$35,800

c. Maria's tax liability is $4,102 [$970 + (0.12 x ($35,800 - $9,700))].

I:2-55 a. $2,047 tax savings. As a dependent, Pam's standard deduction is limited to the greater of $350 ($0 earned income plus $350) or $1,100. Her standard deduction thus is $1,100, and her taxable income is $12,900 ($14,000 AGI minus $1,100). Pam is under age 18, so the kiddie tax applies to her. Pam's tax is calculated as follows:

Net unearned income = $14,000 - $1,100 - $1,100 = $11,800

Earned taxable income = $12,900 - $11,800 = $1,100

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A 10% tax rate applies to the first $3,700 ($1,100 + $2,600) of Pam's taxable income, a 24% tax rate applies to her taxable income exceeding $3,700 but not exceeding $10,400 ($1,100 + $9,300), and a 35% tax rate applies to her taxable income exceeding $10,400 but not exceeding $13,850 ($1,100 + $12,750). Pam's tax thus is $2,853 [(0.10 x $3,700) + (0.24 x ($10,400 - $3,700)) + (0.35 x ($12,900 - $10,400))].

If Ralph and Tina had not transferred the bonds to Pam, they would have received the interest and been taxed on it. Their $500,000 taxable income is in the 35% tax bracket, so the tax would have been $4,900 (0.35 x $14,000). By transferring the bonds to Pam, the family saves $2,047 ($4,900 - $2,853) of tax in the current year.

b. $3,546 tax savings. Pam's taxable income is $12,900 (see part a), but the kiddie tax does not apply to her. Using the tax rate schedule for a single individual, Pam's tax is $1,354. If Ralph and Tina had not transferred the bonds to Pam, the tax on the $14,000 of interest would have been $4,900 (see part a). By transferring the bonds to Pam, the family saves $3,546 ($4,900 - $1,354) of tax in the current year.

I-2:56 a. Gail's 2019 filing status is married filing jointly because she and her husband were married when he died (assuming Gail does not choose to file separately from her deceased husband). Gail qualifies as a surviving spouse for 2020 and 2021 and as a head of household for 2022 and 2023. Gail's son attains age 17 in 2023, so she can claim a $2,000 child credit for him in 2019 through 2022 and a $500 credit for him in 2023. Gail's tax each year is calculated as follows:

	2019	*2020*	*2021*	*2022*	*2023*
Adjusted gross income	$150,000	$150,000	$150,000	$150,000	$150,000
Greater of standard deduction or itemized deductions	(24,400)[a]	(24,400)[a]	(24,400)[a]	(24,000)[b]	(24,000)[b]
Taxable income	$125,600	$125,600	$125,600	$126,000	$126,000
Gross tax	$19,349	$19,349	$19,349	$22,994	$22,994
Credit for child or other dependent	(2,000)	(2,000)	(2,000)	(2,000)	(500)
Net tax	$17,349	$17,349	$17,349	$20,994	$22,494

[a] Greater of $24,000 itemized deductions or $24,400 standard deduction allowed for a married couple filing jointly and for a surviving spouse.
[b] Greater of $24,000 itemized deductions or $18,350 standard deduction allowed for a head of household.

b. As in part a, Gail's 2019 filing status is married filing jointly. Gail does not qualify as a surviving spouse or head of household in any of the subsequent years because the son who lives with her is not her dependent. Her filing status those years is single, and she is not allowed any credit for a child or other dependent. Gail's tax each year is calculated as follows:

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2019: Gross tax is $19,349 (see part a). Net tax also is $19,349.

2020: Gail's claims itemized deductions because their $24,000 amount exceeds the $12,200 standard deduction she is allowed. Her taxable income is $126,000 ($150,000 - $24,000), and her gross tax is $24,415. Her net tax also is $24,415.

2021: $24,415 (see 2020).

2022: $24,415 (see 2020).

2023: $24,415 (see 2020).

Tax Strategy and Critical Thinking Problems

I:2-57 The tax liability under the three alternatives is computed as below:

Business income:	**Proprietorship**	**S Corporation**	**C Corporation**
Income before Jack's compensation	$190,000	$190,000	$190,000
Compensation paid to Jack		(100,000)	(100,000)
Net	$190,000	$ 90,000	$ 90,000
Corporate income tax			$ 18,900
Jack's income:			
Business income	$190,000	$ 90,000	
Compensation		100,000	$100,000
Dividends			7,500
Other income	5,000	5,000	5,000
Adjusted gross income	$195,000	$195,000	$112,500
Itemized deductions	(20,000)	(20,000)	(20,000)
Qualified business income deduction	(35,000)[a]	(18,000)[b]	-0-
Taxable income	$140,000	$157,000	$ 92,500
Individual income tax	$ 27,775	$ 31,855	$ 15,700
Total tax	$ 27,775	$ 31,855	$ 34,600

[a]20% x $190,000 = $38,000, but limited to $35,000 (20% x ($195,000 - $20,000)).
[b]20% x $90,000 = $18,000, which is within the $35,000 limitation.

The total tax paid when Jack operates the business as a sole proprietorship is less than when he operates is as an S corporation because the qualified business income (QBI) deduction is greater with a sole proprietorship than with an S corporation. This difference occurs because the QBI deduction is allowed for flow-through income but not salary income. Jack could increase his QBI deduction with the S corporation organizational form by decreasing the salary, but the IRS might challenge this reduced amount as being unreasonably low.

In this case, the total tax for the current year is highest with the C corporation organizational form, and the analysis does not consider the potential future individual income tax on the remaining

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$63,600 ($90,000 - $18,900 - $7,500) of corporate income when the corporation distributes that income. An important reason the tax is higher is that Jack obtains no QBI deduction with the C corporation. This detriment, however, could be mitigated or reversed if the business becomes more profitable. With a C corporation, the additional profits would be taxed at 21% (plus a 15% or 20% tax when distributed to Jack as a dividend, depending on the extent to which it is more profitable). With a sole proprietorship or S corporation, the additional profits could be taxed to Jack in the 32% or a higher tax bracket.

I:2-58 a. Andrea will save $740 (37% x $2,000) if she makes the contribution.

b. Andrea's taxes will not change because the contribution is not deductible.

c. Andrea will save $222 (37% x $600) if she makes the gift. Given the amount of her income, the daughter will owe no tax because the $600 will be offset by a $1,100 standard deduction.

d. Andrea will save $222 (37% x $600), assuming there is no gain or loss on the sale. She however will not be as well off because the tax-exempt interest of $300 is less than the after-tax interest of $378 ($600 - $222) from the taxable bonds.

I:2-59 The tax law does not limit the amount of income Nell and Nick can shift to Toni, but the tax savings the family can realize is limited because of the kiddie tax. Some of Toni's interest would be offset by her standard deduction and thus be tax-free. The interest exceeding her standard deduction would be taxed at progressively higher rates under the kiddie tax (10%, 24%, 35%, and 37% tax rates). To the extent Toni is taxed on the interest at a rate of less than 35%, the family's total taxes will be reduced. However, if Nell and Nick transfer too many corporate bonds to Toni, some of the interest will be taxed at 35% (or 37%), resulting in no tax savings (or increased taxes).

The maximum amount of the corporate bonds Nell and Nick can transfer to Toni so the interest from them is taxed to Toni at less than a 35% rate can be determined algebraically. Let z be the amount of bonds transferred:

Interest generated by z bonds = 0.048z (all of this is unearned income)

Toni's taxable income = 0.048z - 1,100*

* Standard deduction limited to greater of $350 ($0 earned income plus $350) or $1,100

Toni's net unearned income = 0.048z - 1,100 - 1,100 = 0.048z - 2,200

Toni's earned taxable income (ETI) = (0.048z - 1,100) - (0.048z - 2,200) = 1,100

Under the kiddie tax, the 24% tax bracket ends and the 35% tax bracket begins at taxable income of ETI plus $9,300, which is $10,400 for Toni. Set the formula for Toni's taxable income to equal $10,400 and solve for z:

0.048z - 1,100 = 10,400
z = 239,583

If Nell and Nick transfer $239,583 (or less) of the corporate bonds to Toni, all the interest on those bonds will be taxed to Toni at less than a 35% rate.

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The $239,583 is larger than the $15,000 annual exclusion for the gift tax for 2019 (Chapter I:1), although Nell and Nick can each use the $15,000 amount. To avoid gift tax implications, Nell and Nick could transfer the bonds to Toni over several years, limiting the amount transferred each year to double the annual exclusion. Nell and Nick should also consider nontax implications of these transfers. For example, upon reaching the age of majority (e.g., 18 or 21), Toni would be free to sell the bonds and use the proceeds for whatever purposes she desires, regardless of Nell and Nick's approval or disapproval.

An alternative way of determining the $239,583 is to use an Excel worksheet. Set a cell to an arbitrary value for z (the cell is A1 for this explanation). Another cell (A2 here) contains the formula for Toni's taxable income [=(0.048*A1)-1100)]. A third cell (A3) contains the formula for Toni's net unearned income [=(0.048*a1)-2200], and a fourth cell (A4) contains the formula for the taxable income at which Toni's 24% tax bracket ends and her 35% tax bracket begins [=(A2-A3)+9300]. Excel's Goal Seek feature can then be used, setting cell A2 to the value in cell A4 by changing cell A1.

Tax Form/Return Preparation Problems

I:2-60 (See Instructor's Resource Manual)

I:2-61 (See Instructor's Resource Manual)

I:2-62 (See Instructor's Resource Manual)

Case Study Problems

I:2-63 This question has some interesting implications. One problem relates to the sale of the loss property. Bala and Ann can only deduct $3,000 of the capital loss from ordinary income each year. As a result, it would take ten years to use up the loss unless they realize a capital gain against which to offset the loss. Although a $3,000 capital loss offsets income that would otherwise be taxed at 37%, it takes a long time to use up the loss. If Bala and Ann sell both of the parcels they own they will realize a net loss of $8,000, which will be used up in the current and next two years even if they realize no additional gains. Further, the $8,000 net loss will offset income that would otherwise be taxed at 37%.

Kim is a dependent of her parents and has no other income, so her taxable income if the land were sold would be $17,900 ($19,000 - $1,100 standard deduction). Because she is age 16, Kim is subject to the kiddie tax. Her net unearned income would be $16,800 ($19,000 - $1,100 - $1,100), and her earned taxable income would be $1,100 ($17,900 - $16,800). Her $17,900 taxable income is comprised entirely of long-term capital gain, so $3,750 ($1,100 + $2,650) would be taxed at 0%, $10,300 (($1,100 + $12,950) - $3,750) would be taxed at 15%, and the remaining $3,850 ($17,900 - $3,750 - $10,300) would be taxed at 20%. The total tax would be $2,315 ((15% x $10,300) + (20% x $3,850)). By waiting to sell her land when she is no longer subject to the kiddie tax, more of the gain may be taxed at 0% or 15%, depending on her income at that time. pp. I:2-26 and I:2-30.

I:2-64 As Larry and Sue were married at the end of the year, they can file either a joint income tax return or two separate returns. On the surface, there is not much difference between the tax

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liability on a joint return versus separate returns. The important issue here is the fact that Sue believes that Larry may be under-reporting tip income. If they file a joint return, Sue may be liable for the joint tax liability including penalties that may result from under-reporting. There is an innocent spouse provision, but one condition for claiming innocent spouse status is that the taxpayer did not know and had no reason to know that there was under-reporting. As Sue is suspicious of her husband, she should file a separate return to protect herself from possible tax liability associated with unreported income. pp. I:2-32 and I:2-33.

Tax Research Problems

I:2-65 None of the three individuals qualify as Ed's qualifying children; they do not live with him and thus fail the abode test. A child meets the relationship test for a qualifying relative (Sec. 152(d)(2)(A)), and a child for this purpose includes a stepchild (Sec. 152(f)(1)(A)(i)). Further, Reg. Sec. 1.152-2(d) states that a relationship "once existing will not terminate by divorce or death of a spouse."

On the other hand, Ed is not related to the stepdaughter's husband. Stepson-in-laws are not listed in Sec. 152(d)(2). The Tax Court in Desio Barbetti [9 T.C. 1097 (1947)] held that the term "grandchildren" does not include step-grandchildren, and that neither stepchild nor son-in-law covers stepson-in-laws. Current law refers to children and their descendants, which suggests that the step-grandchild meets the relationship test for a qualifying relative.

Ed's stepdaughter and her child meet all three tests for a qualifying relative, so Ed can claim them as dependents (the problem's facts are such that they meet the gross income and support tests). Ed cannot claim his stepdaughter's husband as a dependent.

I:2-66 The baby can be claimed as a dependent even though he or she lived for only a day. In Rev. Rul. 73-156, 1973-1 C.B. 58, the IRS ruled that dependency may be claimed if state or local law treats the child as having been born alive, and this is evidenced by an official document such as a birth or death certificate. If the child had no Social Security number, the IRS instructs taxpayers to enter "Died" in place of the Social Security number on Form 1040.

I:2-67 Although Larry may not meet the technical definition of "blind" when he wears the new contact lens, the fact that he can only wear the lens for brief times means that he cannot depend on having the advantage of improved sight. Therefore, the Tax Court in Emanuel Hollman, 38 T.C. 251 (1963) granted an extra personal exemption for blindness permitted under prior law. It seems likely that the same rule would be available to taxpayers today claiming the additional standard deduction amount available to blind taxpayers under current law.

"What Would You Do In This Situation?" Solution

Ch. I:2, p. I:2-24.

A married person has the option of filing a joint return or as a married person filing separately. Whether a person is married depends on the laws of the state of residence. The

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abandoned spouse rules provide an exception, but the rules only apply if the taxpayer maintains a household for a dependent child. This case does not indicate that Jane has a child.

State laws establish conditions that must be met for a missing person to be declared legally dead. Typically, a missing person cannot be declared legally dead for seven years. During the interim, a guardian can be appointed to handle the affairs of the missing person. This all taken together indicates that Jane is still classified as a married person for tax purposes.

The IRS has ruled that a spouse who is appointed guardian may elect to file a joint return with his or her missing spouse (Rev. Rul. 55-387, 1955-1 CB 131). The joint return would enable Jane to take advantage of the lower rate schedule and utilize a larger standard deduction. Before she could file a joint return, Jane would have to be appointed as Jim's guardian.

Choosing to file a joint return does have some risks. Jane does not know how much income Jim has or whether he is even alive. Should she file a joint return, the innocent spouse provision probably would protect Jane from tax on any income that Jim may be earning.

One unusual aspect of the situation is that the IRS may know of her husband's status. This is because the IRS would have any return that Jim is filing and have information on any income that is being reported under his social security number on 1099's and W-2's. The IRS is prohibited from giving out information on taxpayers including where they live. As a result, it is unclear what the IRS would do with the information should Jane file a joint return.

Jane could file for a divorce. If the divorce were granted before year end, Jane would file as a single taxpayer. Also, if Jim is declared legally dead Jane will file as a single taxpayer.

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