# Answers to Selected PAK Problems
# Unit06. PAK Chapter 7 Itemized Deductions

**I:0-1** The cost of the trip most likely would not be deductible because of the personal enjoyment factor. However, because Bill's doctor recommended the trip specifically as treatment for his ulcer, an argument could be made to deduct the cost of the trip costs as treatment for a specific ailment. pp. I:7-3 and I:7-4.

**I:0-2** If the premiums cover more than just health care or long-term care for the chronically ill, (i.e. coverage for loss of income or life) and the cost of the separate items are not identified as a component of the total premium, then none of the premiums are deductible. p. I:7-6.

**I:0-11** Cash method taxpayers deduct all state taxes in the year paid or withheld. A refund of state taxes must be included in gross income to the extent a tax benefit was received in the year the deduction was taken. p. I:7-10.

**I:0-25** No charitable contribution deduction is available. In 2009, a married taxpayer filing a joint return is allowed the greater of the standard deduction of $11,400 or itemized deductions. In this situation, the itemized deductions total only $7,000 and the taxpayer would use the standard deduction. p. I:7-2.

**I:0-29** Some of the more common miscellaneous itemized deductions include: expenses incurred in connection with the determination, collection, or refund of any tax (e.g. tax return preparation fees, accountant fees for a tax audit, fees paid for a private letter ruling, appraisal fees to determine the amount of a casualty loss or of a charitable contribution, and legal fees for tax estate planning), expenses associated with a hobby up to the income generated from the hobby, expenses associated with an investment activity other than one which generates rental and royalty income (safe deposit boxes, subscriptions to investment journals, bank service charges on investment accounts), and non-reimbursed employee business expenses. Note, however, that expenses of determining a tax which are incurred in connection with a taxpayer's (1) trade or business, or (2) an activity which produces rents or royalties are deductions <u>for</u> AGI. Miscellaneous itemized deductions are deductible only when the total exceeds 2% of AGI. In addition, for 2009 these items are reduced by 1% (1/3 of 3%) of the taxpayer's AGI in excess of $166,800 ($83,400 for married filing separately). pp. I:7-28 and I:7-29.

**I:0-35**

| | | | |
|---|---|---|---|
| AGI | | | $58,000 |
| Less itemized deductions: | | | |
| Medical*: Doctor bills | $11,700 | | |
| Hospital bills | 9,400 | | |
| Health premiums | 600 | | |
| Total | $21,700 | | |
| Less: Reimbursement | (10,000) | | |
| Less: 7.5% AGI | ( 4,350) | | |
| Deductible medical expenses | | $ 7,350 | |
| Mortgage interest | | 2,750 | |

| | | |
|---|---|---|
| Total itemized deductions | $10,100 | |
| Compare to standard deduction | 5,700 | |
| Deduction (itemized deduction > standard deduction) | | ( 10,100) |
| Personal exemption | | ( 3,650) |
| Taxable income | | $44,250 |

*The legal fees do not meet the definition of medical expenses in Sec. 213 of the IRC.

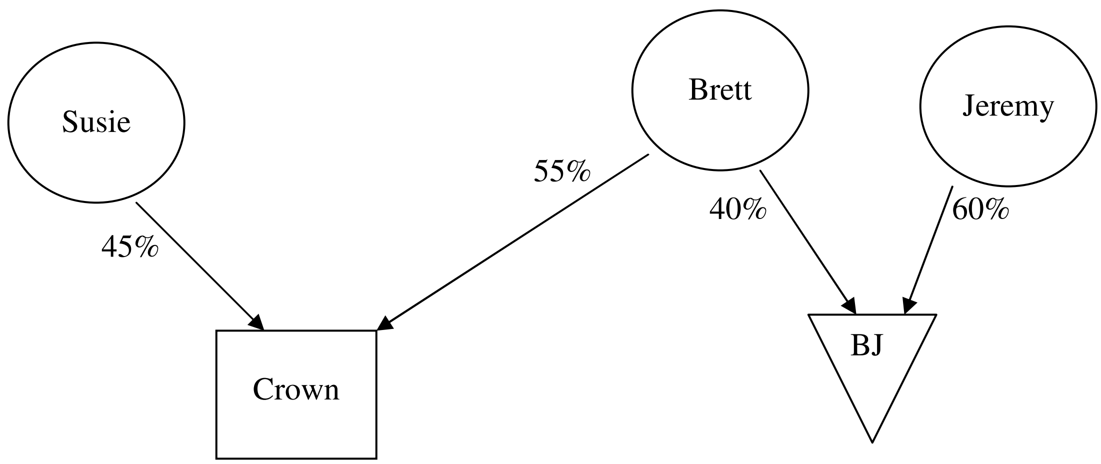
pp. I:7-3 through I:7-6.

**I:0-42** a. Dawn's 2009 deduction for her taxes is as follows:

| | |
|---|---|
| State income taxes | $2,000 |
| Ad valorem property taxes on the car (20,000 x 0.02) | 400 |
| Her portion of the property taxes on the house (104/365 x $1,850) | 527 |
| Itemized deduction for taxes | $2,927 |

b. Dawn will report this deduction on Form 1040 Schedule A. pp. I:7-9 through I:7-11.

**I:0-48**




a. Crown can deduct the entire interest accrued because it and BJ Partnership are not related parties. The same person does not own over 50% of both the partnership and corporation.

b. If Jeremy were Brett's brother, Brett would constructively own 100% of BJ Partnership. Thus, Brett would own over 50% of both Crown Corp. and BJ Partnership. Crown could only deduct the interest in the period in which BJ Partnership would recognize the interest income, which would be the next year.

p.I:7-20.

**I:0-59**

| | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|
| Amount of deduction | $25,000 | $27,500 | $29,000 | $22,500 |

| | | | | |
|---|---|---|---|---|
| Amount of carryover<br>from 2006<br>from 2007 | 15,000 | 15,000<br>1,500 | 11,000<br>1,500 | -0-<br>-0- |

pp. I:7-25 and I:7-26.

**I:7-60**

| | | | |
|---|---|---|---|
| Wages | | | $170,000 |
| | | | 3,888 |
| Capital Gains/Losses: Cabinets, Inc. | | ( 2,700) | |
| The Outdoor Corporation | | 3,900 | |
| | | | 1,200 |
| **Total AGI** | | | **$175,088** |
| Less itemized deductions: | | | |
| Medical expenses | $ 4,900 | | |
| Reduced by 7.5% AGI | ( 13,132) | -0- | |
| State income taxes | | | |
| Withheld from Tim | 8,500 | | |
| Withheld from Monica | 85 | | |
| Paid with 2008 return | 250 | | |
| | | $ 8,835 | |
| Charitable contribution | | | |
| FMV donated asset | $ 96,000 | | |
| Limited to 30% AGI | 52,526 | | |
| Allowed deduction | | $52,526 | |
| Mortgage interest | | | |
| Paid on original loan | 2,300 | | |
| Paid on home equity loan | 850 | | |
| | | $ 3,150 | |
| Miscellaneous itemized | | | |
| Tax advice | 700 | | |
| Subscriptions | 400 | | |
| AMA membership fee | 250 | | |
| | 1,350 | | |
| Reduced by 2% AGI | ( 3,502) | -0- | |
| Total itemized deductions | | $64,511 | |
| AGI | $175,088 | | |
| Itemized deduction limitation threshold | ( 166,800) | | |
| Excess AGI over threshold | 8,288 | | |
| Times: Reduction percentage | x .01 | ( 83)* | |
| Reduction | | | |
| **Total allowable itemized deductions** | | | **$ 64,428** |
| **Less: Exemption amount ($3,650 x 2)** | | | **7,300**** |

| | |
|---|---|
| **Less total exemption amount** | |
| **Net taxable income** | **$103,360** |

*80% overall limit does not apply.
**No reduction of personal exemptions.

**I:7-65** Mr. Brian Brown
100 East Rosebrook
Mesa, Arizona 85203

Dear Mr. Brown:

As you have requested, we have determined the tax consequences of your donation of land to the Rosepark Community College. As we understand them, the facts are as follows:

1. Your estimated adjusted gross income for the current year is $100,000. Since you plan on retiring next year, you anticipate that your adjusted gross income will be $35,000 for all future years.

2. For federal income tax purposes, you file a joint return with your wife.

3. You purchased the land 14 months ago for $50,000. The land's current appraised value is $58,000.

4. Selling the land and donating the cash is not an alternative.

5. You do not anticipate any additional large charitable contributions in the future.

6. You feel that an appropriate discount rate is 10%.

Because the results of our analysis are based upon these facts as we understand them, if the facts are not as stated, please notify us immediately.

In general, the amount of a contribution of long-term capital property is the fair market value of the property. Thus, under the general rule, the amount of your contribution is $58,000. However, such deductions are subject to an annual limitation of 30% of your adjusted gross income. Any excess is carried over and deducted in subsequent years.

If you choose this general rule, your discounted tax savings are as follows:

| Year | Deduction Limited: 30% AGI | X | Marginal Tax Rate | X | Discount | = | Savings |
|---|---|---|---|---|---|---|---|
| 2009 | $30,000 | | .25 | | 1.00 | | $ 7,500 |
| 2010 | 10,500 | | .15* | | 0.91 | | 1,433 |
| 2011 | 10,500 | | .15* | | 0.83 | | 1,307 |
| 2012 | 7,000 | | .15* | | 0.75 | | 788 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Totals | $58,000 | | | | | | | $11,028 |

*Depending on other itemized deductions, this rate could be 10%.

Alternatively, you may make an election to reduce the amount of the contribution from the property's fair market value to your cost in the property. If you make the election, the amount of your contribution would be reduced from $58,000 to $50,000. However, if this election is made, the annual limitation increases to 50% of your adjusted gross income.

If you choose this alternative, your discounted tax savings are as follows:

| **Year** | **Deduction Limited: 50% AGI** | **X** | **Marginal Tax Rate** | **X** | **Discount** | **=** | **Savings** |
|---|---|---|---|---|---|---|---|
| 2009 | $50,000 | | .25 | | 1.00 | | $12,500 |

By making the election, your discounted tax savings are $1,472 higher than if you were to use the general rule. Thus, our recommendation is that you make the election.

We will be happy to help you make this election, as well as help you in any other tax matter or question you may have. If you have any questions, please feel free to call.

Sincerely,

p. I:7-32 and I:7-33.