Unit08. Answers to Selected PAK Questions

# Chapter 9. Employee Expenses and Deferred Compensation

## Discussion Questions

**I:0-1** The deductibility and classification of Matt's transportation and unreimbursed travel expenses depends upon the nature of the expenditure. The transportation and unreimbursed travel expenses incurred in Matt's employment are deductible from AGI as an itemized deduction subject to the 2% nondeductible floor for miscellaneous itemized deductions. The 1% (reduced from 2% for 2006 and 2007) scale down of total itemized deductions for upper-income taxpayers under Sec. 68 may also apply to reduce the deductible amount of unreimbursed employee expenses. The transportation and travel expenses incurred in his CPA practice are business-related and are deductible for AGI and are not subject to the aforementioned limitations. pp. I:9-2 through I:9-4.

**I:0-2**

| | Deductible For AGI | Deductible From AGI | Non-Deductible | 2% Nondeductible Floor | 50% Deductible |
|---|---|---|---|---|---|
| a. Reimbursed business meals | X[a] | | | | |
| b. Auto expenses going to and from work | | | X | | |
| c. Legal expenses in preparation of the taxpayer's tax return | | X | | X | |
| d. Unreimbursed employee travel | | X | | X | X[b] |
| and transportation expenses | | X | | X | X |
| e. Unreimbursed entertainment expenses | X | | | | |
| f. Qualified moving expense of an | | | | X | |
| employee | | X | | | |
| g. Education-related expenses involving tuition and books | | | | | |

[a]Since pursuant to an accountable plan, the reimbursement is not included in gross income and the expense is not deductible. The 50% reduction is applied at the employer level.
[b]Business meals are subject to the 50% deduction limit. pp. I:9-2 through I:9-23.

**I:0-3** a. All expenses except personal clothing (e.g., transportation, meals and lodging) are deductible from AGI and are subject to the 2% nondeductible floor. The meal costs of $1,000 must be reduced by 50%. Thus, the total deductible amount is $8,500 ($9,000 - $500) (subject to the 2% nondeductible floor). Note that the 1% scale-down of total itemized deductions for upper-income individuals may also apply if her AGI is in excess of $166,800 (2009).

b. Same as a. Latoya could deduct the expenses for the nine-month assignment, as that employment would be considered temporary under Rev. Rul. 93-86. None of her expenses incurred in Texas after the nine-month assignment would be deductible. pp. I:9-4 through I:9-7.

**I:0-4** Bass may deduct $450 in 2009. The deduction is computed as follows:

$ 900 (The deduction is limited to the face value of the tickets)
x 0.50 (Then the 50% limit is applied)
$ 450 Deduction.

p. I:9-16.

**I:0-5** a. Yes, Maggie is entitled to an office-in home deduction because the office is used exclusively on a regular basis as the principal place of business for a trade or business and it is used as a place for meeting or dealing with patients, clients, or customers in the normal course of business. Additionally, her office is the most significant place for the conduct of her business activities.

b. No, Marty must prove that working at home is for the convenience of his employer and that it is not merely helpful or appropriate to work at home. An employee must also meet the other requirements described in part a.

c. For years after 1998, an office in home qualifies as a taxpayer's principal place of business if (1) the office is used by the taxpayer for administrative or management activities of the taxpayer's trade or business, and (2) there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities of the trade or business. Since Bobby does not have an office at another location and he conducts substantially all of his administrative and management activities from his office in his home, he will be able to deduct office in home expenses. pp. I:9-24 through I:9-26.

## Problems

**I:0-52** a. Mike's deduction for employment-related expenses is computed as follows:

Subject to 2% floor:

| | |
|---|---|
| Automobile expenses | $2,500 |
| Entertainment ($1,500 x 0.50) | 750 |
| Travel (excluding meals) | 2,000 |
| Meals ($500 x 0.50) | 250 |
| Professional dues | 500 |
| Total | $6,000 |

The moving expenses are deductible for AGI, thus Mike's AGI is $116,000 ($120,000 - $4,000).

$116,000 AGI x 0.02 = $2,320 nondeductible expense floor
$6,000 - $2,320 = $3,680 miscellaneous itemized deductions from AGI
+ 4,000 moving expenses for AGI not subject to any limit
$7,680 total deductible expenses

The 1% scale down of total itemized deductions does not apply because Mike's AGI is not in excess of $166,800 (2009).

b. Moving expenses are deducted <u>for</u> AGI whereas the remaining items are deducted <u>from</u> AGI on Schedule A. pp. I:9-4, I:9-5, I:9-13 and I:9-14, I:9-19 and I:9-20.

**I:0-53** a.

| | |
|---|---|
| Travel | $4,000 |
| Business meals ($1,000 x 0.50) | 500 |
| Transportation | 2,000 |
| Entertainment ($2,000 x 0.50) | 1,000 |
| Total deductible expenses | $7,500 |

Commuting expenses are not deductible. For the local transportation expenses, Monique can compute her deductible expense under either the actual or standard mileage rate method.

b. Each of these items are classified as a <u>for</u> AGI deduction because she is self-employed.

c. If Monique is an employee, then these employment-related expenses are deductible <u>from</u> AGI (subject to the 2% limitation on miscellaneous itemized deductions). pp. I:9-4 and I:9-5, I:9-9 and I:9-10, I:9-13 and I:9-14, I:9-19 and I:9-20..

**I:0-57** a. Since the reimbursement is less than the expenses, an allocation is required. The $3,000 reimbursement is prorated to the various expenses based upon the amount reimbursed to the total expenditures (3,000/5,000 = 60%). The deductible amounts are shown below.

| **<u>Expense</u>** | **Total** | **For AGI (60%)** | **From AGI (40%)** |
|---|---|---|---|
| Professional dues and subscriptions | $1,000 | 600 | 400 |
| Airfare and lodging | 2,000 | 1,200 | 800 |
| Local transportation | 1,000 | 600 | 400 |
| Entertainment | 1,000 | 600 | 200 (400 x 50%) |
| Totals | $5,000 | $3,000 | $1,800 |

b. The $3,000 of reimbursed expenses is deductible <u>for</u> AGI and the $1,800 of unreimbursed expenses are <u>from</u> AGI subject to the 2% of AGI nondeductible floor. Since the reimbursement is pursuant to an accountable plan, the $3,000 of <u>for</u> AGI expenses and the $3,000 reimbursement are netted together and are not reported on Maxine's return. Because Maxine has other miscellaneous itemized deductions of $1,000, a total of $1,600 of miscellaneous itemized deductions are deductible ($2,800 miscellaneous itemized deductions - [0.02 x $60,000 AGI] = $1,600). The 1% scale down of Maxine's total itemized deductions is not applicable because her AGI is not in excess of $166,800 (2009).

c. If Maxine received a $6,000 reimbursement, the $5,000 of employment-related expenses is fully deductible for AGI and Maxine must return the $1,000 excess amount to her employer. Since the reimbursement is pursuant to an accountable plan, the $5,000 of <u>for</u> AGI expenses and the $5,000 reimbursement is netted together and is not reported on Maxine's return. If she does not return the $1,000 excess amount, the $1,000 is includible in her gross income.

pp. I:9-4 through I:9-18.

**I:0-76** a. Paula must provide comparable coverage for her nurse who is an eligible full-time employee. For example, if she contributes 25% of her earned income, a comparable benefit rate must be contributed based upon the salary payments to the nurse.

b. For AGI. The deductible amount is the lesser of 25% of compensation or $46,000 for 2009. However, if Paula elects the maximum 25% rate, she must reduce the percentage for her contribution. Paula's rate would be 20% (0.25/1.0 + 0.25). Thus, her maximum contribution in 2009 would be $20,000 ($100,000 x 0.20).

c. Yes, because she is a full-time employee. In addition, she must contribute 25% of the nurse's earned income.

b. If the contributions were deductible then they are taxable when the funds are withdrawn and a nondeductible 10% penalty tax is imposed upon the amounts withdrawn unless one of the exceptions provided in Sec. 72(t) applies such as death, or disability of the taxpayer. pp. I:9-37.

## Case Study Problems

**I:9-83** The following points should be stressed in the client memo:

1. Ajax needs to expand its equity base because of its high debt/equity ratio and needs for growth.
2. Management philosophy favors employee stock ownership for employees and executives.
3. Conditions are favorable to offer compensation arrangements involving qualified and nonqualified plan arrangements because the company's stock is publicly traded.
4. A Sec. 401(k) and or an ESOP plan should be considered for employees as a supplement to the existing qualified pension plan because current pension benefits are minimal. An ESOP offers attractive cash flow advantages to the company.
5. A nonqualified plan such as a restricted property arrangement involving Ajax stock is needed to attract, motivate, and retain key executives. A nonqualified plan may discriminate in favor of key executives.
6. An incentive stock option plan should be considered for employees and/or executives as a means to raising additional equity capital. An ISO results in deferral of immediate taxation to employees and eventual capital gain treatment although Ajax receives no direct tax benefit unless a nonqualified stock option plan is adopted.