

Acct 218 – chapter 6 – review



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Multiple Choice 6-1

Child Tax Credit (LO 6. 1)

Russ and Linda are married and file a joint tax return claiming their three children, ages 4, 7, and 18, as dependents. Their adjusted gross income for 2015 is \$105, 300. What is Russ and Linda's total child credit for 2015?

\$2, 000

Note: For an individual taxpayer to claim the child tax credit, certain criteria must be met.

Post-Submission:

Taxpayers are permitted to take a tax credit based on the number of their dependent children. The children must be under age 17, U. S. citizens, claimed as dependents on the taxpayer's return, and meet the definition of "qualifying child."

For a child to be a dependent, he or she must meet the following tests:

Relationship test - child must be the taxpayer's child, stepchild, or adopted child or the taxpayer's brother/sister, half-brother/half-sister, or stepsibling or descendant of any of these.

Domicile test - the child must have the same principal place of abode as the taxpayer for more than half the year.

Age test - the child must be under age 19 or a full-time student under the age of 24.

Joint return test - the child must not file a joint return with his or her spouse.

Citizenship test - the dependent must be a United States citizen, a resident

of the United States, Canada, or Mexico or an alien child adopted by and living with a U. S. citizen.

Self-support test - a child who provides more than one-half of his or her own support cannot be claimed as a dependent of someone else.

For 2015, the child tax credit is \$1, 000 per qualifying child. The available credit begins phasing out when AGI reaches \$110, 000 for joint filers (\$55, 000 for married taxpayers filing separately) and \$75, 000 for single or head of household taxpayers. The credit is phased out by \$50 for each \$1, 000 (or part thereof) of AGI above the threshold amounts.

Russ and Linda have two dependent children under the age of 17. Therefore, the available child tax credit is \$2, 000 ($\$1, 000 \times 2$). The credit is not subject to the phaseout because their AGI is below the \$110, 000 threshold for joint filers.

Multiple Choice 6-2

Child Tax Credit (LO 6. 1)

Jennifer is divorced and files a head of household tax return claiming her children, ages 4, 7, and 17, as dependents. Her adjusted gross income for 2015 is \$91, 300. What is Jennifer's total child credit for 2015?

\$1, 150

Note: For an individual taxpayer to claim the child tax credit, certain criteria must be met. And, you round up when phasing out.

Post-Submission:

Taxpayers are permitted to take a tax credit based on the number of their

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dependent children. The children must be under age 17, U. S. citizens, claimed as dependents on the taxpayer's return, and meet the definition of "qualifying child."

The available credit begins phasing out when AGI reaches \$110, 000 for joint filers (\$55, 000 for married filing separately) and \$75, 000 for single or head of household taxpayers. The credit is phased out by \$50 for each \$1, 000 (or part thereof) of AGI above the threshold amounts.

For 2015, the child tax credit is \$1, 000 per qualifying child, or \$2, 000 total.

Jennifer's credit is calculated as follows:

-Full credit for qualifying children ($\$1,000 \times 2$) | \$2, 000

-Phase out reduction* | (\$850)

-Jennifer's child tax credit, 2015 | \$1, 150

* $(\$50 \times [\$91,300 - \$75,000] / \$1,000) = (\$50 \times [\$16,300 / \$1,000]) = (\$50 \times 17) = \$850$ (Note: Recall that the credit is phased out by \$50 for each \$1, 000 (or part thereof). So, $[\$16,300 / \$1,000] = 16.3$ and is rounded up to 17 to cover "or part thereof").

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90/PAGE Order Now Multiple Choice 6-3

Earned Income Credit (LO 6. 2)

Assuming they all meet the income requirements, which of the following taxpayers qualify for the earned income credit in 2015?

A single taxpayer who is self-employed and has a dependent child.

Note: The earned income credit (or EIC) is available to qualifying individuals with earned income and AGI below certain levels.

Post-Submission:

To be eligible for the credit with no qualifying children, a worker must be over 25 and under 65 years old and not be claimed as a dependent by another taxpayer.

There is no age requirement for taxpayers with qualifying children. Also, married taxpayers must file a joint return in order to receive any earned income credit. For a child to be a dependent, he or she must meet the following tests:

-Relationship test - child must be the taxpayer's child, stepchild, or adopted child or the taxpayer's brother/sister, half-brother/half-sister, or stepsibling or descendant of any of these.

-Domicile test - the child must have the same principal place of abode as the taxpayer for more than half the year.

-Age test - the child must be under age 19 or a full-time student under the age of 24.

Joint return test - the child must not file a joint return with his or her spouse.

-Citizenship test - the dependent must be a United States citizen, a resident of the United States, Canada, or Mexico or an alien child adopted by and living with a U. S. citizen.

-Self-support test - a child who provides more than one-half of his or her own support cannot be claimed as a dependent of someone else.

Multiple Choice 6-4

Child and Dependent Care Credit (LO 6. 3)

Which of the following payments does not qualify as a child care expense for purposes of the child and dependent care credit?

Payments to the taxpayer's dependent brother (16 years old) for daytime babysitting.

Note: Taxpayers are allowed a credit for expenses for the care of their children and certain other dependents. The expenses that qualify for the credit include amounts paid to enable both the taxpayer and his or her spouse to be employed. While payments to relatives are eligible for the credit, there are exceptions.

Post-Submission:

The expenses that qualify for the credit include amounts paid to enable both the taxpayer and his or her spouse to be employed. Qualified expenses include amounts paid for in-home care, such as a housekeeper, as well as out-of-home care, such as a day care center. Overnight camps do not qualify for the credit, nor do activities providing standard education. Day camps such as soccer camps and dinosaur camps do not qualify for the credit since they are considered more "fun and games" than education.

Payments to relatives are eligible for the credit unless the payments are to a dependent of the taxpayer or to the taxpayer's child who is under the age of 19 at the end of the tax year.

The payments do not qualify because the payments are to the taxpayer's dependent brother who is under the age of 19.

Multiple Choice 6-5

Individual Shared Responsibility (LO 6. 4)

Which of the following taxpayers will require a payment for the individual shared responsibility?

Bill, a self-employed architect, had a physical in January and was found to be in good health so he canceled his health insurance policy starting in February. His income for the year was about \$110, 000.

Note: There is a " penalty tax" for failing to carry health insurance at a minimum level. The individual shared responsibility provisions require a taxpayer and members of the taxpayer's family to have minimum essential coverage (MEC) or an exemption from MEC.

Post-Submission:

There is a " penalty tax" for failing to carry health insurance at a minimum level. The individual shared responsibility provisions require a taxpayer and members of the taxpayer's family to have minimum essential coverage (MEC) or an exemption from MEC. Alternatively, the taxpayer must pay a tax (referred to as the individual shared responsibility) when filing the 2015 federal income tax return in 2016. MEC is the level of coverage required by

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the ACA and is intended to ensure that the health insurance purchased by taxpayers covers essential health benefits that might be needed by taxpayers and their families. Taxpayers will typically obtain MEC health insurance through their employer, by purchasing directly from an insurance company or by purchasing coverage through one of the health insurance marketplaces (or exchanges) operated by a state or the federal government.

If the minimum premiums for MEC are more than 8 percent of the taxpayer's income, then the taxpayer is exempt from the shared responsibility tax. In addition, a gap in MEC of less than three consecutive months does not require a payment of the shared responsibility. There are also other hardship exemptions from the payment available. Taxpayers using an exemption to avoid the individual shared responsibility should file Form 8965.

For 2015, the annual individual shared responsibility is the greater of (1) 2% of the household income above the required filing threshold for the taxpayer's filing status or (2) the 2015 flat annual dollar amount of \$325 per adult and \$162.50 per child limited to a family maximum of \$975.

Jim is exempt the individual shared responsibility tax because his gross income is below the filing threshold for his filing status. Peg is exempt because her gap of coverage is less than three months. Alice is exempt because she filed a Form 8965, Health Coverage exemption.

However, Bill's will be required to make a payment because there was gap in the MEC of more than three consecutive months and his household income exceeded the required filing threshold for his filing status.

Multiple Choice 6-6

Individual Shared Responsibility (LO 6. 4)

James did not have minimum essential coverage for any part of 2015. If James is single and has 2015 adjusted gross income of \$48,000, what is his individual shared responsibility payment?

\$754

Note: There is a "penalty tax" for failing to carry health insurance at a minimum level. The individual shared responsibility provisions require a taxpayer and members of the taxpayer's family to have minimum essential coverage (MEC) or an exemption from MEC.

Post-Submission:

There is a "penalty tax" for failing to carry health insurance at a minimum level. The individual shared responsibility provisions require a taxpayer and members of the taxpayer's family to have minimum essential coverage (MEC) or an exemption from MEC. Alternatively, the taxpayer must pay a tax (referred to as the individual shared responsibility) when filing the 2015 federal income tax return in 2016. MEC is the level of coverage required by the ACA and is intended to ensure that the health insurance purchased by taxpayers covers essential health benefits that might be needed by taxpayers and their families. Taxpayers will typically obtain MEC health insurance through their employer, by purchasing directly from an insurance company or by purchasing coverage through one of the health insurance marketplaces (or exchanges) operated by a state or the federal government.

If the minimum premiums for MEC are more than 8 percent of the taxpayer's income, then the taxpayer is exempt from the shared responsibility tax. In addition, a gap in MEC of less than three consecutive months does not require a payment of the shared responsibility. There are also other hardship exemptions from the payment available. Taxpayers using an exemption to avoid the individual shared responsibility should file Form 8965.

For 2015, the annual individual shared responsibility is the greater of (1) 2% of the household income above the required filing threshold for the taxpayer's filing status or (2) the 2015 flat annual dollar amount of \$325 per adult and \$162.50 per child limited to a family maximum of \$975.

James' payment is the greater of \$754 (rounded) $[(\$48,000 - \$10,300) \times 2\%]$ or \$95.

$$*(\$4,000 + \$6,300) = \$10,300$$

Multiple Choice 6-7

(LO 6.4)

Which of the following is not an acceptable cause for claiming an exemption from minimum essential coverage?

An international student that has been in the U. S. for more than 5 years and is now a U. S. tax resident

Note: There is a "penalty tax" for failing to carry health insurance at a minimum level. The individual shared responsibility provisions require a

taxpayer and members of the taxpayer's family to have minimum essential coverage (MEC) or an exemption from MEC.

Post-Submission:

There is a "penalty tax" for failing to carry health insurance at a minimum level. The individual shared responsibility provisions require a taxpayer and members of the taxpayer's family to have minimum essential coverage (MEC) or an exemption from MEC. Alternatively, the taxpayer must pay a tax (referred to as the individual shared responsibility) when filing the 2015 federal income tax return in 2016. MEC is the level of coverage required by the ACA and is intended to ensure that the health insurance purchased by taxpayers covers essential health benefits that might be needed by taxpayers and their families. Taxpayers will typically obtain MEC health insurance through their employer, by purchasing directly from an insurance company or by purchasing coverage through one of the health insurance marketplaces (or exchanges) operated by a state or the federal government.

Some taxpayers are exempt from carrying MEC. Exemptions from MEC are reported to the IRS on Form 8965. Some marketplace exemptions include religious opposition, general hardship, and unaffordability based on projected income. For example, if the minimum premiums for MEC are more than 8 percent of the taxpayer's income or gross income is less than the taxpayer's required filing threshold, then the taxpayer is exempt from the shared responsibility tax. In addition, a gap in MEC of less than three consecutive months does not require a payment of the shared responsibility.

However, an international student that has been in the U. S. for more than 5 years and is now a U. S. tax resident would not be exempt.

Multiple Choice 6-8

(LO 6. 4)

Taxpayers with minimum essential coverage for the entire year for all members of their household will

Check a box indicating " full coverage" on their tax return and are generally done reporting under the ACA

Note: MEC is the level of health coverage required by the ACA and is intended to ensure that the health insurance purchased by taxpayers covers essential health benefits that might be needed by taxpayers and their families.

Post-Submission:

MEC is the level of health coverage required by the ACA and is intended to ensure that the health insurance purchased by taxpayers covers essential health benefits that might be needed by taxpayers and their families.

For many taxpayers with MEC for the full year, tax reporting will consist of checking the Full Coverage box on line 61 for Form 1040, line 38 on Form 1040A, or line 11 on Form 1040EZ.

If a taxpayer or any member of the household was without MEC for even part of the year and no exemption applies, the taxpayer will need to report and pay the shared responsibility tax.

Multiple Choice 6-9

(LO 6. 4)

Taxpayers without minimum essential coverage for part of the year that are not eligible for an exemption must

Determine their shared responsibility payment

Note: MEC is the level of health coverage required by the ACA and is intended to ensure that the health insurance purchased by taxpayers covers essential health benefits that might be needed by taxpayers and their families.

Post-Submission:

There is a "penalty tax" for failing to carry health insurance at a minimum level. The individual shared responsibility provisions require a taxpayer and members of the taxpayer's family to have minimum essential coverage (MEC) or an exemption from MEC. Alternatively, the taxpayer must pay a tax (referred to as the individual shared responsibility) when filing the 2015 federal income tax return in 2016.

Taxpayers will typically obtain MEC health insurance through their employer, by purchasing directly from an insurance company or by purchasing coverage through one of the health insurance marketplaces (or exchanges) operated by a state or the federal government.

If the minimum premiums for MEC are more than 8 percent of the taxpayer's income, then the taxpayer is exempt from the shared responsibility tax. In addition, a gap in MEC of less than three consecutive months does not

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require a payment of the shared responsibility. There are also other hardship exemptions from the payment available. Taxpayers using an exemption to avoid the individual shared responsibility should file Form 8965.

Taxpayers who do not meet one of the requirements for exemption, must determine their shared responsibility payment.

For 2015, the annual individual shared responsibility is the greater of (1) 2% of the household income above the required filing threshold for the taxpayer's filing status or (2) the 2015 flat annual dollar amount of \$325 per adult and \$162.50 per child limited to a family maximum of \$975.

Multiple Choice 6-10

(LO 6. 4)

For purposes of determining share responsibility, household AGI is

AGI for the taxpayer, spouse and any other household members required to file a tax return plus any tax-exempt income

Note: The shared responsibility is intended to increase over the first few years of the implementation of the MEC provisions. The shared responsibility is based on income and family size, and a modified household AGI.

Post-Submission:

There is a "penalty tax" for failing to carry health insurance at a minimum level. The individual shared responsibility provisions require a taxpayer and members of the taxpayer's family to have minimum essential coverage (MEC) or an exemption from MEC. Alternatively, the taxpayer must pay a tax

(referred to as the individual shared responsibility) when filing the 2015 federal income tax return in 2016.

Taxpayers will typically obtain MEC health insurance through their employer, by purchasing directly from an insurance company or by purchasing coverage through one of the health insurance marketplaces (or exchanges) operated by a state or the federal government.

Household AGI for determining share responsibility includes AGI for the taxpayer, spouse and any other household members required to file a tax return plus any tax-exempt income.

If the minimum premiums for MEC are more than 8 percent of the taxpayer's income, then the taxpayer is exempt from the shared responsibility tax. In addition, a gap in MEC of less than three consecutive months does not require a payment of the shared responsibility. There are also other hardship exemptions from the payment available. Taxpayers using an exemption to avoid the individual shared responsibility should file Form 8965.

For 2015, the annual individual shared responsibility is the greater of (1) 2% of the household income above the required filing threshold for the taxpayer's filing status or (2) the 2015 flat annual dollar amount of \$325 per adult and \$162.50 per child limited to a family maximum of \$975.

Multiple Choice 6-11

Education Tax Credits (LO 6.5)

The American Opportunity credit is 100 percent of the first _____ of tuition and fees paid and 25 percent of the next _____.

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\$2, 000; \$2, 000

Note: The HOPE credit, expanded and renamed the American Opportunity tax credit, and the lifetime learning credit are the education credits available to help qualifying low- and middle-income individuals defray the cost of higher education.

Post-Submission:

The American Opportunity credit is calculated as 100% of the first \$2, 000 of tuition, fees, books, and course materials. Then 25% of the next \$2, 000 for a maximum annual credit per student of \$2, 500. The credit is available for the first 4 years of postsecondary education.

The American Opportunity credit may be claimed for the expenses of students pursuing bachelor's or associate's degrees or vocational training. Room and board, transportation costs, and personal living expenses are not qualifying expenses.

Multiple Choice 6-12

Education Tax Credits (LO 6. 5)

Jane graduates from high school in June 2015. In the fall, she enrolls for six units at Big State University. Big State University considers students who take 12 or more units full-time. Jane's father pays her tuition and fees of \$2, 500 for the fall semester and in December prepays \$2, 500 for the spring semester. In 2015, the American Opportunity credit for Jane's tuition and fees before any AGI limitation is:

\$2, 500

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Note: The HOPE credit, expanded and renamed the American Opportunity tax credit, and the lifetime learning credit are the education credits available to help qualifying low-income and middle-income individuals defray the cost of higher education.

Post-Submission:

The American Opportunity credit is calculated as 100% of the first \$2,000 of tuition, fees, books, and course materials. Then 25% of the next \$2,000 for a maximum annual credit per student of \$2,500. The credit is available for the first 4 years of postsecondary education.

The American Opportunity credit may be claimed for the expenses of students pursuing bachelor's or associate's degrees or vocational training. Room and board, transportation costs, and personal living expenses are not qualifying expenses, which can be paid on behalf of the taxpayer, his or her spouse, or dependents.

A student must carry at least one-half the normal course load for one term during the tax year to qualify for the credit. In addition, the American Opportunity credit is not available for any student convicted of a federal or state drug felony.

The American Opportunity tax credit for Jane's tuition and fees is calculated as follows:

-Level 1: First \$2,000 of qualifying expenses* | \$2,000

-Level 2: 25% of the next \$2,000** of qualifying expenses | 500

-American Opportunity tax credit, 2015 | \$2,500

* Qualifying expenses include tuition, fees, books and course materials.

** $(\$4,000 - \$2,000 \text{ [level 1 amount]}) \times 25\% = \500

Multiple Choice 6-13

Education Tax Credits (LO 6. 5)

In September 2015, Sam pays \$2,200 to take a course to improve his job skills to qualify for a new position at work. Assuming there is no phase-out of the credit, his lifetime learning credit for 2015 is:

None of these are correct.

Correct Answer: \$440

Note: Taxpayers can elect a nonrefundable tax credit of 20 percent, up to \$10,000, for qualified expenses.

Post-Submission:

Taxpayers can elect a nonrefundable tax credit of 20% up to \$10,000 for qualified expenses. Books are qualified under the American Opportunity credit, but not for the lifetime learning credit. The lifetime learning credit is available for expenses paid for education of the taxpayer, his or her spouse, or dependents. The credit is available for undergraduate, graduate, or professional courses at eligible educational institutions.

The lifetime learning credit is phased out at income of \$110,000 to \$130,000 for married taxpayers; \$55,000 and \$65,000 for single and head of household taxpayers. For 2015, the credit is phased out evenly over the phase-out range.

As Sam does not have an AGI higher than the phase out range, his credit for 2015 would be \$440 ($20\% \times \$2,200$).

Multiple Choice 6-14

Education Tax Credits (LO 6. 5)

In November 2015, Simon pays \$6,200 to take a course to improve his job skills to qualify for a new position at work. Simon's employer reimbursed him for the cost of the course. For 2015, Simon's lifetime learning credit is:

\$0

Note: The use of the American Opportunity and lifetime learning credits is limited.

Post-Submission:

Taxpayers can elect a nonrefundable tax credit of 20% up to \$10,000 for qualified expenses. The lifetime learning credit is available for expenses paid for education of the taxpayer, his or her spouse, or dependents. The credit is available for undergraduate, graduate, or professional courses at eligible educational institutions.

The use of the American Opportunity and lifetime learning credits is limited to the following situations:

Married taxpayers must file jointly to claim the credit;

Room and board expenses do not qualify;

Nonacademic fees or expenses unrelated to the course of instruction do not qualify. Expenses for courses that involve sports, games, and hobbies do not

qualify unless the course is part of the degree program;

Qualified educational expenses must be reduced by tax-free scholarships or employer received reimbursements. Expenses paid from a gift or inheritance do qualify for credits;

The credits cannot be used for expenses that are deducted from taxable income on a tax return for education costs; and,

Students claimed as dependents of other taxpayers are not eligible for educational credits. The persons who claim the student as a dependent can claim the educational credit.

As Simon was reimbursed by his employer for the course taken, Simon does not have any expenses that qualify for the lifetime learning credit.

Multiple Choice 6-15

Education Tax Credits (LO 6. 5)

John, a single father, has AGI of \$51, 000 in 2015. During the year, he pays \$4, 000 in qualified tuition for his dependent son, who just started attending Small University. What is John's American Opportunity credit for 2015?

\$2, 500

Note: The American Opportunity tax credit and the Lifetime Learning credit are two tax credits available for qualified education expenses. Both education credits are available to help qualifying low-income and middle-income individuals defray the cost of higher education.

The American Opportunity tax credit is limited to a maximum annual amount per student.

Post-Submission:

The American Opportunity credit may be claimed for the expenses of students pursuing bachelor's or associate's degrees or vocational training. Room and board, transportation costs, and personal living expenses are not qualifying expenses. Tuition, fees, books, and course material expenses that qualify for the American Opportunity credit can be paid on behalf of the taxpayer, his or her spouse, or dependents.

The American Opportunity credit is calculated as 100% of the first \$2,000 of tuition, fees, books, and course materials. Then 25% of the next \$2,000 for a maximum annual credit per student of \$2,500. The credit is available for the first 4 years of postsecondary education.

For 2015, the American Opportunity credit is phased out ratably for joint returns with income between \$160,000 and \$180,000 and for single (or head of household) filers with income between \$80,000 and \$90,000.

The student must carry at least one-half the normal course load for one term during the tax year to qualify for the credit. In addition, the American Opportunity credit is not available for any student convicted of a federal or state drug felony.

The use of the American Opportunity and lifetime learning credits is limited to the following situations:

- Married taxpayers must file jointly to claim the credit;
- Room and board expenses do not qualify;
- Nonacademic fees or expenses unrelated to the course of instruction do not

qualify. -Expenses for courses that involve sports, games, and hobbies do not qualify unless the course is part of the degree program;

-Qualified educational expenses must be reduced by tax-free scholarships or employer received reimbursements. -Expenses paid from a gift or inheritance do qualify for credits;

-The credits cannot be used for expenses that are deducted from taxable income on a tax return for education costs; and,

-Students claimed as dependents of other taxpayers are not eligible for educational credits. The persons who claim the student as a dependent can claim the educational credit.

John's American Opportunity credit for 2015 is calculated as follows:

-Level 1: First \$2, 000 of qualifying expenses* | \$2, 000

-Level 2: 25% of the next \$2, 000** of qualifying expenses | 500

-John's American Opportunity tax credit, 2015 | \$2, 500

* Qualifying expenses include tuition, fees, books and course materials.

** $(\$4, 000 - \$2, 000 \text{ [level 1 amount]}) \times 25\% = \500

Multiple Choice 6-16

Education Tax Credits (LO 6. 5)

Joan, a single mother, has AGI of \$85, 000 in 2015. In September 2015, she pays \$5, 000 in qualified tuition for her dependent son who just started at Big University (BU). What is Joan's American Opportunity credit for 2015?

\$1, 250

Note: The American Opportunity tax credit and the Lifetime Learning credit are two tax credits available for qualified education expenses. Both education credits are available to help qualifying low-income and middle-income individuals defray the cost of higher education.

The American Opportunity tax credit is limited to a maximum annual amount per student.

The American Opportunity credit is phased out ratably if the taxpayer's income exceeds a certain threshold.

Post-Submission:

The American Opportunity credit may be claimed for the expenses of students pursuing bachelor's or associate's degrees or vocational training. Room and board, transportation costs, and personal living expenses are not qualifying expenses. Tuition, fees, books, and course material expenses that qualify for the American Opportunity credit can be paid on behalf of the taxpayer, his or her spouse, or dependents.

The American Opportunity credit is calculated as 100% of the first \$2,000 of tuition, fees, books, and course materials. Then 25% of the next \$2,000 for a maximum annual credit per student of \$2,500. The credit is available for the first 4 years of postsecondary education.

For 2015, the American Opportunity credit is phased out ratably for joint returns with income between \$160,000 and \$180,000 and for single (or head of household filers) with income between \$80,000 and \$90,000.

The student must carry at least one-half the normal course load for one term during the tax year to qualify for the credit. In addition, the American Opportunity credit is not available for any student convicted of a federal or state drug felony.

- Married taxpayers must file jointly to claim the credit;
- Room and board expenses do not qualify;
- Nonacademic fees or expenses unrelated to the course of instruction do not qualify. -Expenses for courses that involve sports, games, and hobbies do not qualify unless the course is part of the degree program;
- Qualified educational expenses must be reduced by tax-free scholarships or employer received reimbursements. -Expenses paid from a gift or inheritance do qualify for credits;
- The credits cannot be used for expenses that are deducted from taxable income on a tax return for education costs; and,
- Students claimed as dependents of other taxpayers are not eligible for educational credits. The persons who claim the student as a dependent can claim the educational credit.

Joan's American Opportunity credit for 2015 is calculated as follows:

- Level 1: First \$2, 000 of qualifying expenses* | \$2, 000
- Level 2: 25% of the next \$2, 000** of qualifying expenses | 500
- Annual maximum credit | \$2, 500
- Phase out amount***: | (1, 250)
- Joan's American Opportunity tax credit, 2015 | \$1, 250

* Qualifying expenses include tuition, fees, books and course materials.

** $(\$4,000 - \$2,000 \text{ [level 1 amount]}) \times 25\% = \500

*** $\$2,500 \times \{[\$90,000 - 85,000] / \$10,000\} = \$2,500 \times (\$5,000 / \$10,000) = \$2,500 \times .5 = \$1,250.$

Multiple Choice 6-17

Education Tax Credits (LO 6. 5)

Becky, a college freshman, works part-time and pays \$1,650 of her college tuition expenses. Although Becky files her own tax return, her parents claim her as a dependent on their tax return. Becky's parents file jointly and have AGI of \$50,000. What is the amount of American Opportunity credit her parents can claim on their tax return for the tuition Becky paid?

\$1,650

Note: The American Opportunity tax credit and the Lifetime Learning credit are two tax credits available for qualified education expenses. Both education credits are available to help qualifying low-income and middle-income individuals defray the cost of higher education.

The American Opportunity tax credit is limited to a maximum annual amount per student.

Post-Submission:

-Level 1: $100\% \times \$1,650 \text{ of qualifying expenses}^* | \$1,650$

* Qualifying expenses include tuition, fees, books and course materials.

Multiple Choice 6-18

Foreign Tax Credit (LO 6. 6)

Taxpayer L has income of \$55, 000 from Norway, which imposes a 40 percent income tax, and income of \$45, 000 from France, which imposes a 30 percent income tax. L has taxable income from U. S. sources of \$200, 000 and U. S. tax liability before credits of \$105, 000. What is the amount of the foreign tax credit?

\$35, 000

Math:

$$((\$55, 000 + \$45, 000) / (\$55, 000 + \$45, 000 + \$200, 000)) \times \$105, 000 = \$35, 000$$

Note: U. S. taxpayers are allowed to claim a foreign tax credit on income earned in a foreign country and subject to income taxes in that country. You can elect to claim a deduction or claim the credit.

Post-Submission:

Foreign taxes:

Norway tax liability ($\$55, 000 \times 40\%$) \$22, 000

France tax liability ($\$45, 000 \times 30\%$) 13, 500

Total foreign taxes paid \$35, 500

Overall limitation:

(Net foreign income / U. S. taxable income) x U. S. tax liability* \$35, 000

$[(\$55, 000 + 45, 000) / (\$55, 000 + \$45, 000 + \$200, 000)] \times \$105, 000$

Multiple Choice 6-19

Adoption Expenses (LO 6. 7)

John and Joan pay \$16, 500 of qualified adoption expenses in 2015 to finalize the adoption of a qualified child. Their AGI is \$197, 000 for 2015. What is their adoption credit for 2015?

\$13, 400

Book: " The credit is the total amount for each adoption and is not an annual amount (i. e., there is only one \$13, 400 credit per adopted child)."

Note: Taxpayers are allowed two tax breaks for adoption expenses. A tax credit is allowed for qualified adoption expenses paid by taxpayers and an exclusion from W-2 income for qualified adoption expenses paid by the taxpayer's employer.

The adoption credit is reduced if the taxpayer's AGI exceeds a certain threshold.

Post-Submission:

The total expenses that can be taken as a credit for all tax years are \$13, 400. The credit is the total amount for each adoption and is not an annual amount. The amount of the credit allowable for any tax year is reduced for taxpayers with AGIs over \$201, 010 and is fully phased out when AGI reaches \$241, 010. The amount of the credit is reduced (but not below zero) by a factor equal to the excess of the taxpayer's AGI over \$201, 010 divided by \$40, 000.

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorney fees, and other expenses directly related to, and of which the principal purpose is for, the taxpayer's legal adoption of an eligible child.

Although John and Joan paid \$16, 500 of adoption expenses, their adoption credit for 2015 is limited to the maximum allowable amount of \$13, 400.

Multiple Choice 6-20

Adoption Expenses (LO 6. 7)

In connection with the adoption of an eligible child who is a U. S. citizen and who is not a child with special needs, Sean pays \$4, 000 of qualified adoption expenses in 2014 and \$3, 000 of qualified adoption expenses in 2015. The adoption is finalized in 2015. There is no phase-out of the adoption credit.

What are the adoption credits for both 2014 and 2015, respectively?

\$0; \$7, 000

Note: The total expenses that can be taken as a credit with respect to an adoption of a child are \$13, 400, even in multi-year situations.

Post-Submission:

The total expenses that can be taken as a credit for all tax years are \$13, 400 (in 2015). The credit is the total amount for each adoption and is not an annual amount.

Qualified adoption expenses paid or incurred before the tax year in which the adoption becomes final are taken into account for the credit as if the

expenses were paid or incurred in the tax year in which the adoption becomes final. Therefore, the credit for qualified adoption expenses paid or incurred in the tax year in which the adoption becomes final, or in any earlier tax year, is allowed in the tax year the adoption becomes final.

Sean's adoption credit is taken in the year the adoption is finalized (2015) and is for all expenses incurred without regard to the year paid (\$4, 000 + \$3, 000).

Multiple Choice 6-21

Adoption Expenses (LO 6. 7)

In 2015, Irene, an unmarried individual, pays \$6, 500 in qualified adoption expenses to an adoption agency for the final adoption of an eligible child who is not a child with special needs. In the same year, the individual's employer, under a qualified adoption assistance program, pays an additional \$4, 000 for other qualified adoption expenses to an attorney on behalf of Irene for the adoption of the child. Assuming Irene is not subject to the phase-out, she may exclude, from her personal income, how much of the \$4, 000 payment made by her employer?

\$4, 000

Note: Taxpayers are allowed two tax breaks for adoption expenses. Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorney fees, and other expenses directly related to, and of which the principal purpose is for, the taxpayer's legal adoption of an eligible child.

Post-Submission:

Taxpayers are allowed two tax breaks for adoption expenses. A tax credit is allowed for qualified adoption expenses paid by taxpayers, and an exclusion from W-2 income is allowed for qualified adoption expenses paid by taxpayers' employers. An individual may claim both a credit and an exclusion in connection with the adoption of an eligible child, but may not claim both a credit and an exclusion for the same expense.

An employee may exclude from W-2 earnings amounts paid or expenses incurred by his or her employer for qualified adoption expenses connected with the adoption of a child by the employee, if the amounts are furnished under an adoption assistance program. The total amount excludable per child is limited to \$13,400. The excludable amount for any tax year is phased out in the same manner as the phase-out for the adoption credit.

The excludable amount for any tax year is phased out for taxpayers with AGI over \$201,010 and is fully eliminated when AGI reaches \$241,010.

Irene can claim a \$6,500 credit for the adoption agency fees and Irene's employer can exclude from her W-2 earnings the \$4,000 of additional expenses paid by them for attorney adoption fees.

Multiple Choice 6-22**Adoption Expenses (LO 6. 7)**

If a taxpayer does not have enough tax liability to use all the available adoption credit, the unused portion may be carried forward for how many years?

Five

Note: Taxpayers are allowed two tax breaks for adoption expenses. A tax credit is allowed for qualified adoption expenses paid by taxpayers and an exclusion from W-2 income for qualified adoption expenses paid by the taxpayer's employer.

Post-Submission:

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorney fees, and other expenses directly related to, and of which the principal purpose is for, the taxpayer's legal adoption of an eligible child.

The credit (up to \$13,400) for qualified adoption expenses paid or incurred in the tax year in which the adoption becomes final, or in any earlier tax year, is allowed in the tax year the adoption becomes final.

For 2015, the credit is not refundable; however, the unused portion may be carried forward for five years of adoption credit. To claim the credit, married individuals must file jointly, and the taxpayers must include (if known) the name, age, and taxpayer identification number (TIN) of the child of the return.

Multiple Choice 6-23

The Individual Alternative Minimum Tax (AMT) (LO 6. 9)

Which of the following is not a tax preference or adjustment item for the individual alternative minimum tax computation?

All of these choices are adjustments or tax preference items.

- Miscellaneous itemized deductions
- State income taxes
- State income tax refunds
- Interest from specified Private Activity bonds

Note: Many individual taxpayers are subject to two parallel tax calculations, the regular tax and the alternative minimum tax (AMT). The AMT was designed to ensure that wealthy taxpayers could not take advantage of special tax write-offs (tax preferences and other adjustments) to avoid paying tax.

Post-Submission:

In general, taxpayers must pay the alternative minimum tax if their AMT tax liability is larger than their regular tax liability. The AMT is calculated on Form 6251 using a formula to arrive at income subject to AMT.

Some common adjustments and preferences used in the calculation of AMT are as follows:

The standard deduction;

Personal and dependency exemptions;

Medical expenses if limited to 10% of AGI rather than the regular 7.5% for taxpayers 65 and older;

Interest deduction on home equity debt (up to \$100,000) used for the purchase or improvement of a 1st or 2nd home;

Miscellaneous deductions;

Depreciation is calculated over a longer life for AMT;

NOLs are calculated differently for AMT;

State income tax refunds and state income tax deduction;

Interest from specified Private Activity bonds; and,

Other less common items such as incentive stock options, oil and gas depletion, R&D expenses, gains on asset sales (rental real estate), passive losses, and the gain exclusion for small business stock.

Multiple Choice 6-24

Community Property (LO 6. 11)

Dana and Larry are married and live in Texas. Dana earns a salary of \$45,000 and Larry has \$25,000 of rental income from his separate property. If Dana and Larry file separate tax returns, what amount of income must Larry report?

None of these choices are correct.

Answer: \$12,500

INCORRECT:

-\$0

-\$25,000

Note: When married couples file separate income tax returns, a special problem arises. The tax treatment of income from separate property depends on the taxpayer's state of residence.

Post-Submission:

The law in nine states is based on a community property system of marital law. In these states, the property rights of married couples differ from the property rights of married couples residing in common law states (the remaining states). The nine states that are community property states are:

Arizona Louisiana Texas

California Nevada Washington

Idaho New Mexico Wisconsin

Note: In Alaska, spouses may elect to treat income as community income.

Under the community property system, all property is deemed to be either separate property or community property. In Idaho, Louisiana, Texas, and Wisconsin, income from separate property produces community income. Thus, just as each spouse is taxed on half of the income from community property, each spouse is also taxed on half of the income from separate property. In the other five community property states, income on separate property is "separate income" and is reported in full on the tax return of the spouse who owns the property.

Larry must report $\frac{1}{2}$ of Dana's salary (\$22,500) and $\frac{1}{2}$ of the rental income (\$12,500) or \$35,000.

Multiple Choice 6-25

Community Property (LO 6.11)

Which of the following conditions need not be satisfied in order for a married taxpayer, residing in a community property state, to be taxed only on his or her separate salary?

A minor child must be living with the spouse.

MUST be satisfied:

- The husband and wife must live apart for the entire year.
- The husband and wife must not file a joint income tax return.
- The husband and wife must not transfer earned income between themselves.

Note: When married couples file separate income tax returns, a special problem arises. The tax treatment of income from separate property depends on the taxpayer's state of residence.

Post-Submission:

Under the community property system, all property is deemed to be either separate property or community property. Separate property includes property acquired by a spouse before marriage or received after marriage as a gift or inheritance. All other property owned by a married couple is presumed to be community property. For federal income tax purposes, each spouse is automatically taxed on half of the income from community property.

To simplify problems that could arise when married spouses residing in a community property state do not live together, the tax law contains an exception to the above community property rules. Under this special

provision, a spouse will be taxed only on his or her actual earnings from personal services. For this provision to apply, the following conditions must be satisfied:

The individuals must live apart for the entire year;

They must not file a joint return; and,