

Tax treatments for individual returns



Use the following format for your essay. It is based on the grading rubric structure. Identify the item in the appropriate rubric area and then present your reasoning in a paragraph for each tax decision you have made. Use as much space as necessary in each category. (The task instructions give a suggested total length of 2-5 pages.

Recommended Tax Filing Status

The recommended tax filing status for this family is Married Filing Jointly. The reason I would recommend this filing status is that there are three children that are qualifying children, but the college freshman is not under the age of 17 so that child does not qualify for the child tax credit. Spouse B's mother does not qualify as a dependant because she does not meet the minimum requirement of having half of her support come from the family.

The family would be able to take a higher amount of deductions and therefore pay less in taxes if they choose Married Filing Jointly. By filing jointly the couple is able to take advantages of such credits as the child tax credit, the Lifetime Learning Credit & the hope credit. They are also able to save more into retirement plans than they would have been filing separately.

Taxable and Non-Taxable Income

Spouse A's income from his K-1 from Fan Company A is taxable income. Spouse A's cash withdrawals are not taxable because they are accounted for on his K-1 as part of his income from the partnership. Spouse A's income as a part time referee is taxable. Spouse B's earnings as the controller for the electronics firm are taxable. Dividends from Company E stocks are taxable.

The interest from the municipal bond is non-taxable.

The losses that Spouse B suffered from day trading would be an offset against all other taxable income and would need to be reported on Form 8949 and Schedule D. The income from the rental properties would be taxable.

The gain from selling their home is not taxable because it falls within the \$250,000 limit for gains from selling a primary residence. The \$200 per month that Spouse B receives for child support is not considered taxable income.

Capital Gains and Losses

The \$44,000 profit from the sale of the rental house is a taxable gain because it was not the family's main residence. The \$5,000 stock trading loss that Spouse B incurred would be a capital loss. But only \$3,000 of the loss will be able to be deducted in the current year, the other \$2,000 will be a loss carryover. The rule for Capital Gains & Losses is that when a capital asset is sold, the difference between the amount you paid for the asset and the amount you sold it for is a capital gain or capital loss.

A2c. Profit or Losses from Sale of Property

The profit from selling the family's main residence is not considered to be a taxable gain because the family lived there for more than 2 years within the past 5 years and because the gain on the sale was less than \$500,000. The amount of the exclusion for the couple is \$296,000.

Partnership Income and Losses

Spouse A's \$142,000 income from his K-1 is his partnership income. This is included in his taxable income. Spouse A's cash withdrawals are not taxable

because they are accounted for on his K-1 as part of his income from the partnership. Only Spouse A's share of the net income of the partnership is considered to be his taxable income.

Passive Activity Gains and Losses

The family had a passive activity loss of \$6, 200 from their rental properties because the family does not materially participate in the business. Passive activity losses can only offset passive activity income, and passive activity tax credits can only be used against tax attributable to passive activity income on your tax return. The \$44, 000 profit from the sale of the rental house is a passive gain.

Adjustments to Income (on the 1040 form this area is called Adjusted Gross Income) Spouse A's \$600 monthly alimony is a deductible expense because his ex-spouse has to pay income tax Spouse A's deductible portion of his Self Employment tax on his \$142, 000 partnership income would be an adjustment because an individual is able to deduct the amount of taxes that an employer would normally pay. Moving expenses are not able to be used as an adjustment to income because the family did not lessen the commute by at least 50 miles.

The passive loss from the rental properties are an adjustment to gross income. The money that Spouse A contributes to his Keogh retirement plan is not an adjustment to gross income because it is not one of the specified types of retirement plans that are able to be used as an adjustment.

Deductions

The Family should take the standard tax deduction because I do not believe that their itemized deductions will total more than the standard deduction.

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The donations to charity are tax deductible as long as the couple kept up with records and can itemize each deduction. This would be reported on schedule A. Spouse B's new wardrobe for her new job is not tax deductible because the clothes can be worn for other occasions than just work. The family will not be able to take their healthcare costs as a deduction because the medical costs did not equal 7.5% of their income.

Tax credits

A tax credit is an amount of money that is able to be subtracted from the actual amount of taxes that a taxpayer owes. This will reduce the amount of taxes that the family has to pay to the IRS. Spouse A will not get a credit for his Keogh Plan contributions because the family's AGI will be too high. The family will get a child tax credit for each of the two children under 17. It may be possible for the family to get an Education credit for their College freshman and deduct some of the eligible expenses. American Opportunity Tax Credit to deduct up to \$2,500 for expenses of their college freshman. The credit is phased out for incomes above \$160,000.