

# INCOME TAX FUNDAMENTALS

WHITTENBURG / GILL

2020



INCLUDES



2020

# Income Tax FUNDAMENTALS

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**Income Tax Fundamentals, 2020 Edition**  
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Library of Congress Control Number: 2019916757

ISBN: 978-0-357-10823-9

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# CONCISE, CURRENT, & PRACTICAL!

## *Income Tax Fundamentals'*

### Winning Forms Approach Is Time-Tested

**I***ncome Tax Fundamentals 2020 Edition* is designed as a self-contained book for an introductory course in individual income taxation. We take pride in the concise, current, and practical coverage of the income tax return preparation process. *Income Tax Fundamentals* continues to be the **market-leading textbook** with a tax forms-based approach that is a reliable choice, with an experienced author team that offers a commitment to accuracy. The workbook format of the textbook presents materials in practical sections with multiple examples and review problems. The presentation of the material does not assume that the reader has taken a course in accounting, making it appropriate for use as a self-study guide to federal income tax. *Income Tax Fundamentals* adopters tell us:

*Great text. I have used it for years mostly because of its simple and straightforward approach to the basic income tax elements.*

— Jerold K. Braun, Daytona State College

*This text provides an excellent overview for community tax classes. The software gives these students good hands-on experience with the concepts.*

— Jay Wright, New River Community College

*I love this book with all its comprehensive problems that progress from easy to difficult.*

— LoAnn Nelson, PhD, CPA, Lake Region State College

*The layout of the chapters is well-thought out.*

— James Hromadka, San Jacinto College

*I enjoy using the Whittenburg text...it is the best I have found.*

— Jana Hosmer, Blue Ridge Community College

Whittenburg and Gill's hallmark "**Forms Approach**" allows students to practice filling out tax returns right in the book while also having the option to download tax forms online. *Income Tax Fundamentals* has been redesigned to follow the new Form 1040 and supporting Schedules 1 through 3. Every attempt to align the concepts with the schedules has been made so students can follow from the detailed form to the schedule and eventually to Form 1040.



Each individual tax form required to complete the problems in the textbook is included within *Income Tax Fundamentals* and within the complimentary Intuit ProConnect Online.

ProConnect Online is an industry-leading tax preparation software that is hosted on the cloud and provides robust tax content and easy navigation. The Intuit website offers community and knowledge-based content, view alerts, and FAQ articles. All of the 2019 individual income tax return problems in the textbook may be solved using the Intuit software, or students may prepare the tax returns by hand.



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# Income Tax Fundamentals

## Evolves Each Year to Benefit You

### NEW TO THIS EDITION

#### The Tax Cuts and Jobs Act (TCJA) of 2017

Although most of the new tax law became effective at the start of 2018, a significant amount of administrative tax guidance has followed in the last 24 months. New IRS notices, revenue rulings, and procedures have been reviewed and analyzed with the new material being included in this edition when appropriate. Improved clarity on the qualified business income deduction and the lapse of the individual shared responsibility for health care are notable changes that are covered.

#### A New Form 1040 and Schedules (again)

Never leave well enough alone. The postcard-size Form 1040 and six schedules have been replaced by a more sizable Form 1040 and three schedules. In addition, a new Form 1040-SR has been introduced for taxpayers age 65 and older. All of these form changes, plus new qualified business income deduction forms, are covered in the same seamless forms-based approach in previous editions.

#### Introduction of additional real-life source documents

We continue to include commonly used source documents in the exercises and tax return problems such as Form W-2, a myriad of Forms 1099, Form 1095-A, and additional accounting schedules such as trial balances and income statements in an effort to replicate the tax return preparation process more closely. Information that is not relevant to the problem is included to encourage students to use analytical and critical-thinking skills to deal with less structured problems.

#### Latest Tax Law is included

Compared to 2018, the degree of tax law changes has been small, but *Income Tax Fundamentals* continues to monitor all changes through October 2019. Recent guidance on the qualified business income deduction and bonus depreciation is covered in this edition.

### UPDATED CUMULATIVE SOFTWARE PROBLEM

The cumulative software problem included as Group 5 questions at the end of Chapters 1–8 have been updated to include more source documents (Form W-2s, 1099s, etc.) and include extraneous information to encourage students to think more critically about the relevance of certain items when preparing tax returns.

### A COMPLETE LEARNING SYSTEM—CENGAGENOWv2



CengageNOWv2 for Taxation takes students from motivation to mastery. It elevates thinking by providing superior content designed with the entire student workflow in mind. Students learn more efficiently with the variety of engaging assessments and learning tools. For instructors, CengageNOWv2 provides ultimate control and customization and a clear view into student performance that allows for the opportunity to tailor the learning experience to improve outcomes.

#### Motivation

Many instructors find that students come to class unmotivated and unprepared. To help with engagement and preparedness, CengageNOWv2 for Whittenburg offers the following feature:

**Self-Study Questions** based on the information presented in the textbook help students prepare for class lectures or review prior to an exam. Self-Study Questions provide ample practice for the students as they read the chapters, while providing them with valuable feedback and checks along the way, as the solutions are provided conveniently in Appendix E of the textbook.

#### Application

Students need to learn problem-solving skills in order to complete taxation problems on their own. However, as students try to work through homework problems, sometimes they become stuck and need guidance. To help reinforce concepts and keep students on the right track, CengageNOWv2 for Whittenburg offers the following:

- **End-of-chapter homework: Group 1 and 2 problems**
- **Algorithmic versions** of end-of-chapter homework are available for at least 10–15 problems per chapter.

- **Detailed feedback for each homework question.** Homework questions include enhanced, immediate feedback so students can learn as they go. Levels of feedback include an option for “check my work” prior to submission of an assignment. Then, after submitting an assignment, students receive even more extensive feedback explaining why their answers were incorrect. Instructors can decide how much feedback their students receive and when, including providing the full solution, if they wish.
- Built-in **Test Bank** for online assessment.

For students who need additional support, CengageNOWv2’s **Adaptive Study Plan** is complete with quizzes, an eBook, and more.

- It is designed to help give students additional support and prepare them for the exam.

## Mastery

Finally, students need to make the leap from memorizing concepts to critical thinking. They need to be able to connect multiple topics and master the material. To help students grasp the big picture of taxation, tax return preparation, and achieve the end goal of mastery, CengageNOWv2 for Whittenburg offers the following:

**Comprehensive Problems** allow students to complete the tax return problems by entering the relevant information on tax forms and schedules in the Intuit ProConnect Online tax software or by manually preparing the tax forms and schedules provided within each chapter.

## Cengage Learning Testing Powered by Cognero®

Cognero® is a flexible, online system that allows instructors to:

- author, edit, and manage test bank content from multiple Cengage Learning solutions
- create multiple test versions in an instant
- deliver tests from your LMS, your classroom or wherever you want

Cognero® possesses the features necessary to make assessment fast, efficient, and effective:

- **Simplicity at every step.** A desktop-inspired interface features drop-down menus and familiar, intuitive tools.
- **Full-featured test generator.** Choose from 15 question types (including true/false, multiple choice, and essay). Multi-language support, an equation editor, and unlimited metadata help ensure your tests are complete and compliant.
- **Cross-compatible capability.** Import and export content into other systems.

CL Testing Powered by **Cognero®** is accessible through the instructor companion site, [www.cengage.com/login](http://www.cengage.com/login).

## Key Terms

Key Terms with page references are located at the end of all of the chapters and reinforce the important tax terms introduced in each chapter.

## Key Points

Following the Key Terms is a brief summary of the learning objective highlights for each chapter to allow students to focus quickly on the main points of each chapter.

# RELIABLE INSTRUCTOR RESOURCES ARE CONVENIENT

## Solutions Manual

The manual contains detailed solutions to the end-of-chapter problems in the textbook, Chapter Outlines and Suggested Minimum Assignments, and the Additional Comprehensive Problems that are located in Appendix D.

## Comprehensive Instructor Companion Website

This password-protected site contains instructor resources: the Solutions Manual, the Test Bank, Cognero® testing tools, Solutions to the Cumulative Tax Return Problems, Intuit ProConnect Online software solutions and instructions, PowerPoints, and more: [www.cengage.com/login](http://www.cengage.com/login).

# AS WE GO TO PRESS

To access tax law information after the publication of this textbook, please visit [www.cengage.com](http://www.cengage.com). At the home page, input the ISBN of your textbook (from the back cover of your book). This will take you to the product page where free companion resources are located.

# Step-by-Step Format Builds Student Confidence

The practical, step-by-step format in *Income Tax Fundamentals 2020 Edition* builds from simple to complex topics. The authors are careful to lead students down a path of understanding rather than overwhelming them with excessive detail and multiple Internal Revenue Code references.

- Helpful examples within each chapter provide realistic scenarios for students to consider.

**EXAMPLE** Scott provides all of the support for an unrelated family friend who lives with him for the entire tax year. He also supports a cousin who lives in another state. The family friend can qualify as Scott's dependent, but the cousin cannot. The family friend meets the member of the household test. Even though the cousin is not considered a relative, he could have been a dependent if he met the member of the household part of the test. ♦

- The short Learning Objective sections within each chapter offer numerous examples, supported by the "Self-Study Problems" throughout. The Self-Study Problems encourage students to answer a series of short questions in a fill-in-the-blank or multiple-choice format. The solutions to the Self-Study Problems are provided at the end of the textbook, offering immediate solutions to students to help build confidence.

- The Quick Tax Reference Guide on the inside of the back cover of the textbook includes the Tax Equation.

MARRIED FILING JOINTLY OR QUALIFYING WIDOWER		
\$0	\$19,400	
\$19,400	\$78,950	10% of taxable income *
\$78,950	\$100,000	\$1,940.00 + 12% of the excess over \$19,400 =
\$100,000	\$168,400	\$9,086.00 + 22% of the excess over \$78,950 =
\$168,400	\$321,450	\$9,086.00 + 22% of the excess over \$78,950 =
\$321,450	\$408,200	\$28,765.00 + 24% of the excess over \$168,400 =
\$408,200	\$612,350	\$65,497.00 + 32% of the excess over \$321,450 =
\$612,350		\$89,257.00 + 35% of the excess over \$408,200 =
		\$164,709.50 + 37% of the excess over \$612,350 =

MARRIED FILING SEPARATELY		
\$0	\$9,700	
\$9,700	\$39,475	10% of taxable income *
\$39,475	\$84,200	\$970.00 + 12% of the excess over \$9,700 =
\$84,200	\$100,000	\$4,543.00 + 22% of the excess over \$39,475 =
\$100,000	\$160,725	\$14,382.50 + 24% of the excess over \$84,200 =
\$160,725	\$204,100	\$14,382.50 + 24% of the excess over \$84,200 =
\$204,100	\$306,175	\$32,748.50 + 32% of the excess over \$160,725 =
\$306,175		\$46,628.50 + 35% of the excess over \$204,100 =
		\$82,354.75 + 37% of the excess over \$306,175 =

**LEARNING OBJECTIVES**

After completing this chapter, you should be able to:

- LO 1.1 Explain the history and objectives of U.S. tax law.
- LO 1.2 Describe the different entities subject to tax and reporting requirements.
- LO 1.3 Apply the tax formula for individuals.
- LO 1.4 Identify individuals who must file tax returns.
- LO 1.5 Determine filing status and understand the calculation of tax according to filing status.

- Learning Objectives help organize information and are referenced by the end-of-chapter exercises.





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# Real-World Applications Keep Students Engaged

**Would You Sign This Tax Return?**

Your client, William Warrant, was hired for a management position at an Internet company planning to start a website called "indulgedanimals.com" for dogs, cats, and other pets. When he was hired, William was given an incentive stock option (ISO) worth \$500,000, which he exercised during the year. Exercise of the ISO creates a tax preference item for alternative minimum tax (AMT) and causes him to have to pay substantial additional tax when combined with his other tax items for the year. He is livid about the extra tax and refuses to file the AMT Form 6251 with his tax return because the AMT tax is "unfair" and "un-American" according to him. Would you sign this tax return?

- The "Would You Sign This Tax Return?" feature places readers in the office of a tax preparer with interesting and sometimes humorous real-world tax ethics questions that will intrigue students. Many of these features are inspired by the authors' own experiences working with various clients in tax preparation. As part of each scenario, students decide if they would sign the tax return. The instructor can use the cases to spark group discussions on basic tax preparation ethics.

- Real-world examples within Tax Break segments provide actual, effective examples of tax-planning strategies that clearly illustrate the concepts discussed throughout the book and cover nearly every basic tax-planning technique used by tax preparers.

**TAX BREAK**

Divorcing couples may save significant taxes if one or both of the spouses qualify as an "abandoned spouse" and can use the head of household filing status. The combination of head of household filing status for one spouse with married filing separately filing status for the other spouse is commonly seen in the year (or years) leading up to a divorce. In cases where each spouse has custody of a child, the separated taxpayers may each claim head of household status.

**Would You Believe?**

The following quotation is often attributed to Albert Einstein: "The hardest thing in the world to understand is the income tax."

- Interesting tax facts within "Would You Believe?" sections grab students' attention with interesting asides, including captivating facts and stories about tax laws and preparation.

- New Tax Law boxes throughout the textbook draw students' attention to specific areas affected by new tax legislation.

**New Tax Law!**

The TCJA made no direct changes to the accumulated earnings tax or the personal holding company tax; however, the significant decrease in the corporate tax rate makes deferring income without distributing the earnings and profits of a corporation considerably more attractive from a tax planning perspective. Undoubtedly, this will increase both the use of this strategy and the IRS' sensitivity to this matter.

# Income Tax Fundamentals

## Delivers Proven End-of-Chapter Strengths

- The pages are perforated, allowing students to complete end-of-chapter problems and submit them for homework. Students can also tear out tax forms as needed.
- Several question types ensure a variety of assignment options:
  - Multiple-Choice Questions
  - Problems
  - Writing Assignments
  - Comprehensive Problems
- The Cumulative Software Problem provided in Chapters 1–8 gives students the flexibility to use multiple resources, such as the tax forms within the book, Intuit ProConnect Online or alternative tax preparation software.

## Digital Tools Enhance Student Understanding



CengageNOWv2 is a powerful online homework tool.

This online resource includes an interactive eBook, end-of-chapter homework, detailed student feedback and interactive quizzing, that covers the most challenging topics, a lab guide

for using the Intuit ProConnect Online software, flashcards, and much more.

The student companion website offers—at no additional costs—study resources for students. Go to [www.cengage.com](http://www.cengage.com), and input the ISBN number of your textbook (from the back cover of your book). This will take you to the product page where free companion resources are located.



Intuit ProConnect Online access is included with each textbook.

A detailed reference lab guide will help the student use the software for solving end-of-chapter problems.

For students who are new to the Intuit ProConnect product, we have placed tips throughout the textbook providing guidance to assist students with the transition from a paper form to using the tax software.



Marc Romanello/Getty Images

# Note to Students: Maximize Your Reading Experience

This book includes many examples to help illustrate learning objectives. After reading each section, including the examples, answer the corresponding Self-Study Problems. You can find the solutions to the Self-Study Problems at the end of the textbook in Appendix E to check your accuracy. Use your performance to measure your understanding, and re-read the Learning Objectives section if needed. Many key tax terms are defined in each chapter, which will help improve your overall comprehension.

## USING TAX SOFTWARE

Numerous tax return problems in the textbook can be solved using either tax preparation software or hand preparation. The popular software, Intuit ProConnect Online, is available with the textbook. Helpful tips for using ProConnect have been placed throughout the book so that students can more easily train on the software and prepare the tax returns included in each of the first eight chapters. A student guide to Intuit ProConnect Online is provided at the companion website. Your college may offer additional tax preparation software, such as Intuit's ProSeries®, but remember that you can always prepare the solutions manually on the chapter-provided tax forms, schedules and worksheets.

## USING THE FEATURE "WOULD YOU SIGN THIS TAX RETURN?"

A practitioner who knows when to say "I cannot sign this tax return," even if it means losing a client, is exercising the most basic ethical wisdom. Most chapters contain a "Would You Sign This Tax Return?" case reflecting a common client issue. Each issue corresponds to an obvious concept illustrated in the previous section. However, the approach to advise the client is not obvious. The art of explaining tax rules to a client who does not understand them, or, worse, wants to break them, requires not only a good understanding of the rules, but also good interpersonal skills and sometimes the gift of persuasion. The news in the last several years has shown reports of respected CPA firms with members who failed to say the simple words, "I cannot sign this tax return," demonstrating that simple ethical practice is not always easy. We hope instructors will use these cases to spark group discussions or contemplation, and, perhaps, add examples from their own experience.

## USING THE CUMULATIVE SOFTWARE PROBLEM

The Cumulative Software Problem can be found at the end of Chapters 1–8. The case information provided in each chapter builds on the information presented in previous chapters, resulting in a lengthy and complex tax return by the conclusion of the problem in Chapter 8. Your instructor may have you work in groups to prepare each of the tax returns. The groups can follow the real-world accounting firm model using a preparer, a reviewer, and a firm owner who takes responsibility for the accuracy of the return and signs it. All of the issues in the problem are commonly seen by tax preparers and are covered in the textbook. The full return is difficult to prepare by hand, so tax software is recommended. If the problem is prepared using tax software, the data should be saved so the additional information in the succeeding chapters can be added without duplicating input from previous chapters.

## ABOUT THE AUTHORS

**Gerald E. Whittenburg** On March 8, 2015, we unexpectedly lost our dear friend and co-author Gene Whittenburg. As the original author of *Income Tax Fundamentals*, Gene was critical in designing the forms-based approach that the book has used successfully for over two decades. Gene started his life in a small town in Texas, entered the Navy, served his country in Vietnam, earned a Bachelor's, Master's, and PhD degrees, and served as a distinguished faculty at San Diego State University for almost 40 years. We intend to continue to honor Gene by committing to uphold his standard of publishing excellence.

**Steven L. Gill** is an associate professor of accounting and taxation in the Charles W. Lamden School of Accountancy at San Diego State University. He also serves as the Director of Graduate Programs at the Fowler College of Business at SDSU. Steve received a BS in Accounting from the University of Florida, an MS in Taxation from Northeastern University, and a PhD in Accounting from the University of Massachusetts. Prior to entering academia, he worked for almost 12 years in the field of tax and accounting, including roles in public accounting, internal audit, corporate accounting, and, ultimately, vice president of finance. Although currently in inactive status, Steve holds a Certified Public Accountant designation. He has published a wide variety of articles in various academic and practitioner journals, and has taught at both the undergraduate and graduate levels, including taxation and financial and management accounting. Steven also serves as an author on Cengage's Federal Tax Research series.

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## ACKNOWLEDGMENTS

The authors wish to thank all of the instructors who provided feedback for the 2020 edition via surveys as well as the following supplement authors and verifiers for their most valuable suggestions and support:

**D. Elizabeth Stone Atkins**—*High Point University, High Point, NC*    **Pennie Eddy**—*Appalachian Technical College, Jasper, GA*  
**David Candelaria**—*Mt. San Jacinto College, Menifee, CA*    **Paul Shinal**—*Cayuga Community College, Auburn, NY*  
**Jim Clarkson**—*San Jacinto College South, Houston, TX*    **Lisa Swallow**—*University of Montana, Missoula, MT*

In addition, gratitude is expressed to Susan Gill, Kathleen Smith, and Steve Smith for their expert assistance reviewing chapters of this textbook. We would also like to thank Janice Stoudemire, and Wendy Shanker on their work of reviewing and verifying the content in CengageNOWv2 including the end-of-chapter items and Test Bank problems. We would also like to extend our thanks to the Tax Forms and Publications Division of the Internal Revenue Service for their assistance in obtaining draft forms each year.

We appreciate your continued support in advising us of any revisions or corrections you feel are appropriate.

Steven L. Gill

# THE ANNOTATED 1040 MAP

The annotated 1040 map is an expanded tax formula, illustrating where each piece of the tax formula is covered in the textbook. The 1040 map helps you understand how all of the elements of the textbook and the tax formula fit together. Use this as a reference and bookmark this page.

**Form 1040** Department of the Treasury—Internal Revenue Service (99) **2019** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

**Filing Status**  Single  Married filing jointly  Married filing separately (MFS)  Head of household (HOH)  Qualifying widow(er) (QW) **LO 1-5**  
 Check only one box. If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶

Your first name and middle initial Last name Your social security number  
 If joint return, spouse's first name and middle initial Last name Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. Apt. no. **Presidential Election Campaign**  
 City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). **LO 1-7** Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund.  You  Spouse

Foreign country name Foreign province/state/county Foreign postal code If more than four dependents, see instructions and ✓ here ▶

**Standard Deduction** **Someone can claim:**  You as a dependent  Your spouse as a dependent  Spouse itemizes on a separate return or you were a dual-status alien **LO 1-6, 7-1**

**Age/Blindness** You:  Were born before January 2, 1955  Are blind **Spouse:**  Was born before January 2, 1955  Is blind

Dependents (see instructions):			(4) ✓ if qualifies for (see instructions):	
(1) First name	Last name	(2) Social security number	Child tax credit	Credit for other dependents
			<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>
			<input type="checkbox"/>	<input type="checkbox"/>

<b>1</b> Wages, salaries, tips, etc. Attach Form(s) W-2	<b>1</b>	<b>LO 2-2</b>
<b>2a</b> Tax-exempt interest	<b>2a</b>	<b>LO 2-10</b>
<b>3a</b> Qualified dividends	<b>3a</b>	<b>LO 2-9</b>
<b>4a</b> IRA distributions	<b>4a</b>	<b>LO 5-3</b>
<b>c</b> Pensions and annuities	<b>4c</b>	<b>LO 2-7</b>
<b>5a</b> Social security benefits	<b>5a</b>	<b>LO 2-16</b>
<b>6</b> Capital gain or (loss). Attach Schedule D if required. If not required, check here	<b>6</b>	<b>LO 4-1 to 4-6</b>
<b>7a</b> Other income from Schedule 1, line 9	<b>7a</b>	
<b>b</b> Add lines 1, 2b, 3b, 4b, 5b, 6, and 7a. This is your <b>total income</b>	<b>7b</b>	
<b>8a</b> Adjustments to income from Schedule 1, line 22	<b>8a</b>	
<b>b</b> Subtract line 8a from line 7b. This is your <b>adjusted gross income</b>	<b>8b</b>	
<b>9</b> <b>Standard deduction or itemized deductions</b> (from Schedule A)	<b>9</b>	<b>LO 1-7, 5-6 to 5-10</b>
<b>10</b> Qualified business income deduction. Attach Form 8995 or Form 8995-A	<b>10</b>	<b>LO 4-10</b>
<b>11a</b> Add lines 9 and 10	<b>11a</b>	
<b>b</b> <b>Taxable income.</b> Subtract line 11a from line 8b	<b>11b</b>	

**Standard Deduction for—**  
 • Single or Married filing separately, \$12,200  
 • Married filing jointly or Qualifying widow(er), \$24,400  
 • Head of household, \$18,350  
 • If you checked any box under Standard Deduction, see instructions.

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• If you have a qualifying child, attach Sch. EIC.  
 • If you have nontaxable combat pay, see instructions.

<b>12a</b>	Tax (see inst.) Check if any from Form(s): 1 <input type="checkbox"/> 8814 2 <input type="checkbox"/> 4972 3 <input type="checkbox"/> _____	<b>12a</b>	LO 1.5, 2.9, 4.4, 6.4	
<b>b</b>	Add Schedule 2, line 3, and line 12a and enter the total			<b>12b</b>
<b>13a</b>	Child tax credit or credit for other dependents	<b>13a</b>	LO 1-7, 7-1	
<b>b</b>	Add Schedule 3, line 7, and line 13a and enter the total			<b>13b</b>
<b>14</b>	Subtract line 13b from line 12b. If zero or less, enter -0-			<b>14</b>
<b>15</b>	Other taxes, including self-employment tax, from Schedule 2, line 10			<b>15</b>
<b>16</b>	Add lines 14 and 15. This is your <b>total tax</b>			<b>16</b>
<b>17</b>	Federal income tax withheld from Forms W-2 and 1099			<b>17</b>
				LO 2-2, 9-1
<b>18</b>	Other payments and refundable credits:			
<b>a</b>	Earned income credit (EIC)	<b>18a</b>	LO 7-2	
<b>b</b>	Additional child tax credit. Attach Schedule 8812	<b>18b</b>	LO 7-1	
<b>c</b>	American opportunity credit from Form 8863, line 8	<b>18c</b>	LO 7-5	
<b>d</b>	Schedule 3, line 14	<b>18d</b>		
<b>e</b>	Add lines 18a through 18d. These are your <b>total other payments and refundable credits</b>			<b>18e</b>
<b>19</b>	Add lines 17 and 18e. These are your <b>total payments</b>			<b>19</b>
<b>20</b>	If line 19 is more than line 16, subtract line 16 from line 19. This is the amount you <b>overpaid</b>			<b>20</b>
<b>21a</b>	Amount of line 20 you want <b>refunded to you</b> . If Form 8888 is attached, check here <input type="checkbox"/>			<b>21a</b>
<b>b</b>	Routing number	<b>c</b>	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
<b>d</b>	Account number			
<b>22</b>	Amount of line 20 you want <b>applied to your 2020 estimated tax</b>	<b>22</b>		
<b>23</b>	<b>Amount you owe.</b> Subtract line 19 from line 16. For details on how to pay, see instructions	<b>23</b>		
<b>24</b>	Estimated tax penalty (see instructions)	<b>24</b>		
<b>Third Party Designee</b>	Do you want to allow another person (other than your paid preparer) to discuss this return with the IRS? See instructions.			<input type="checkbox"/> <b>Yes.</b> Complete below. <input type="checkbox"/> <b>No</b>
(Other than paid preparer)	Designee's name	Phone no.	Personal identification number (PIN)	
<b>Sign Here</b>	Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.			
Joint return? See instructions. Keep a copy for your records.	Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
	Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)
	Phone no.	Email address		
	Preparer's name	Preparer's signature	Date	PTIN
<b>Paid Preparer Use Only</b>	Firm's name	Phone no.	Check if: <input type="checkbox"/> 3rd Party Designee <input type="checkbox"/> Self-employed	
	Firm's address	Firm's EIN		

Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

**SCHEDULE 1**  
(Form 1040 or 1040-SR)

**Additional Income and Adjustments to Income**

OMB No. 1545-0074

**2019**  
Attachment  
Sequence No. **01**

Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040 or 1040-SR.  
▶ Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

Name(s) shown on Form 1040 or 1040-SR

Your social security number

**Part I Additional Income**

<b>1</b>	Taxable refunds, credits, or offsets of state and local income taxes . . . . .	<b>1</b>	LO 5-7
<b>2a</b>	Alimony received . . . . .	<b>2a</b>	LO 2-13
<b>b</b>	Date of original divorce or separation agreement (see instructions) ▶		
<b>3</b>	Business income or (loss). Attach Schedule C . . . . .	<b>3</b>	Chapter 3
<b>4</b>	Other gains or (losses). Attach Form 4797 . . . . .	<b>4</b>	LO 8-8
<b>5</b>	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E . . . . .	<b>5</b>	LO 4-7, 4-8
<b>6</b>	Farm income or (loss). Attach Schedule F . . . . .	<b>6</b>	
<b>7</b>	Unemployment compensation . . . . .	<b>7</b>	LO 2-15
<b>8</b>	Other income. List type and amount ▶	<b>8</b>	LO 2.6, 2.12
<b>9</b>	Combine lines 1 through 8. Enter here and on Form 1040 or 1040-SR, line 7a . . . . .	<b>9</b>	

**Part II Adjustments to Income**

<b>10</b>	Educator expenses . . . . .	<b>10</b>	LO 5-5
<b>11</b>	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 . . . . .	<b>11</b>	LO 5-5
<b>12</b>	Health savings account deduction. Attach Form 8889 . . . . .	<b>12</b>	LO 5-1
<b>13</b>	Moving expenses for members of the Armed Forces. Attach Form 3903 . . . . .	<b>13</b>	LO 5-5
<b>14</b>	Deductible part of self-employment tax. Attach Schedule SE . . . . .	<b>14</b>	LO 6-6
<b>15</b>	Self-employed SEP, SIMPLE, and qualified plans . . . . .	<b>15</b>	LO 5-4
<b>16</b>	Self-employed health insurance deduction . . . . .	<b>16</b>	LO 5-2
<b>17</b>	Penalty on early withdrawal of savings . . . . .	<b>17</b>	LO 2-9
<b>18a</b>	Alimony paid . . . . .	<b>18a</b>	LO 2-13
<b>b</b>	Recipient's SSN . . . . . ▶		
<b>c</b>	Date of original divorce or separation agreement (see instructions) ▶		
<b>19</b>	IRA deduction . . . . .	<b>19</b>	LO 5-3
<b>20</b>	Student loan interest deduction . . . . .	<b>20</b>	LO 5-8
<b>21</b>	Reserved for future use . . . . .	<b>21</b>	
<b>22</b>	Add lines 10 through 21. These are your <b>adjustments to income</b> . Enter here and on Form 1040 or 1040-SR, line 8a . . . . .	<b>22</b>	

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**SCHEDULE 2**  
(Form 1040 or 1040-SR)

**Additional Taxes**

OMB No. 1545-0074

**2019**  
Attachment  
Sequence No. **02**

Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040 or 1040-SR.  
▶ Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

Name(s) shown on Form 1040 or 1040-SR

Your social security number

**Part I Tax**

<b>1</b>	Alternative minimum tax. Attach Form 6251 . . . . .	<b>1</b>	LO 6-5
<b>2</b>	Excess advance premium tax credit repayment. Attach Form 8962 . . . . .	<b>2</b>	LO 7-4
<b>3</b>	Add lines 1 and 2. Enter here and include on Form 1040 or 1040-SR, line 12b . . . . .	<b>3</b>	

**Part II Other Taxes**

<b>4</b>	Self-employment tax. Attach Schedule SE . . . . .	<b>4</b>	LO 6-6
<b>5</b>	Unreported social security and Medicare tax from Form: <b>a</b> <input type="checkbox"/> 4137 <b>b</b> <input type="checkbox"/> 8919 . . . . .	<b>5</b>	
<b>6</b>	Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required . . . . .	<b>6</b>	
<b>7a</b>	Household employment taxes. Attach Schedule H . . . . .	<b>7a</b>	LO 6-7
<b>b</b>	Repayment of first-time homebuyer credit from Form 5405. Attach Form 5405 if required . . . . .	<b>7b</b>	
<b>8</b>	Taxes from: <b>a</b> <input type="checkbox"/> Form 8959 <b>b</b> <input type="checkbox"/> Form 8960 <b>c</b> <input type="checkbox"/> Instructions; enter code(s) . . . . .	<b>8</b>	LO 6-8
<b>9</b>	Section 965 net tax liability installment from Form 965-A . . . . .	<b>9</b>	
<b>10</b>	Add lines 4 through 8. These are your <b>total other taxes</b> . Enter here and on Form 1040 or 1040-SR, line 15 . . . . .	<b>10</b>	

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**SCHEDULE 3**  
(Form 1040 or 1040-SR)

Department of the Treasury  
Internal Revenue Service

**Additional Credits and Payments**

▶ Attach to Form 1040 or 1040-SR.  
▶ Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information.

OMB No. 1545-0074

**2019**  
Attachment  
Sequence No. **03**

Name(s) shown on Form 1040 or 1040-SR

Your social security number

**Part I Nonrefundable Credits**

<b>1</b>	Foreign tax credit. Attach Form 1116 if required . . . . .	<b>1</b>	LO 7-6
<b>2</b>	Credit for child and dependent care expenses. Attach Form 2441 . . . . .	<b>2</b>	LO 7-3
<b>3</b>	Education credits from Form 8863, line 19 . . . . .	<b>3</b>	LO 7-5
<b>4</b>	Retirement savings contributions credit. Attach Form 8880 . . . . .	<b>4</b>	LO 7-9
<b>5</b>	Residential energy credit. Attach Form 5695 . . . . .	<b>5</b>	LO 7-8
<b>6</b>	Other credits from Form: <b>a</b> <input type="checkbox"/> 3800 <b>b</b> <input type="checkbox"/> 8801 <b>c</b> <input type="checkbox"/> . . . . .	<b>6</b>	
<b>7</b>	Add lines 1 through 6. Enter here and include on Form 1040 or 1040-SR, line 13b . . . . .	<b>7</b>	

**Part II Other Payments and Refundable Credits**

<b>8</b>	2019 estimated tax payments and amount applied from 2018 return . . . . .	<b>8</b>	LO 9-2
<b>9</b>	Net premium tax credit. Attach Form 8962 . . . . .	<b>9</b>	LO 7-4
<b>10</b>	Amount paid with request for extension to file (see instructions) . . . . .	<b>10</b>	LO 1-4
<b>11</b>	Excess social security and tier 1 RRTA tax withheld . . . . .	<b>11</b>	
<b>12</b>	Credit for federal tax on fuels. Attach Form 4136 . . . . .	<b>12</b>	
<b>13</b>	Credits from Form: <b>a</b> <input type="checkbox"/> 2439 <b>b</b> <input type="checkbox"/> Reserved <b>c</b> <input type="checkbox"/> 8885 <b>d</b> <input type="checkbox"/> . . . . .	<b>13</b>	
<b>14</b>	Add lines 8 through 13. Enter here and on Form 1040 or 1040-SR, line 18d . . . . .	<b>14</b>	

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Cat. No. 71480G

Schedule 3 (Form 1040 or 1040-SR) 2019

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## QUESTIONS

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## CHAPTER 1

# The Individual Income Tax Return



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## LEARNING OBJECTIVES

*After completing this chapter, you should be able to:*

- LO 1.1** Explain the history and objectives of U.S. tax law.
- LO 1.2** Describe the different entities subject to tax and reporting requirements.
- LO 1.3** Apply the tax formula for individuals.
- LO 1.4** Identify individuals who must file tax returns.
- LO 1.5** Determine filing status and understand the calculation of tax according to filing status.
- LO 1.6** Define qualifying dependents.
- LO 1.7** Calculate the correct standard or itemized deduction amount for taxpayers.
- LO 1.8** Compute basic capital gains and losses.
- LO 1.9** Access and use various Internet tax resources.
- LO 1.10** Describe the basics of electronic filing (e-filing).

## OVERVIEW

**T**his chapter introduces the U.S. individual income tax system. Important elements of the individual tax formula are covered, including the tax calculation, who must file, filing status, and the interaction of itemized deductions and the standard deduction. The chapter illustrates all the steps required for completion of a basic Form 1040. Also included is a discussion of reporting and taxable entities.

An introduction to capital gains and losses is included to provide a basic understanding of capital transactions prior to the detailed coverage in Chapter 4. An overview of tax information available at the Internal Revenue Service (IRS) website and other helpful tax websites is also included. A discussion of the process for electronic filing (e-filing) of an individual tax return completes the chapter.

**Learning Objective 1.1**

Explain the history and objectives of U.S. tax law.

**1-1 HISTORY AND OBJECTIVES OF THE TAX SYSTEM****1-1a Tax Law History and Objectives**

The U.S. income tax was established on March 1, 1913 by the Sixteenth Amendment to the Constitution. Prior to the adoption of this amendment, the U.S. government had levied various income taxes for limited periods of time. For example, an income tax was used to help finance the Civil War. The finding by the courts that the income tax law enacted in 1894 was unconstitutional eventually led to the adoption of the Sixteenth Amendment. Since adoption of the amendment, the constitutionality of the income tax has not been questioned by the federal courts.

Many people inaccurately believe the sole purpose of the income tax is to raise sufficient revenue to operate the government. The tax law has many goals other than raising revenue. These goals fall into two general categories—economic goals and social goals—and it is often unclear which goal a specific tax provision was written to meet. Tax provisions have been used for such economic motives as reduction of unemployment, expansion of investment in productive (capital) assets, and control of inflation. Specific examples of economic tax provisions are the limited allowance for expensing of capital expenditures and the bonus depreciation provisions. In addition to pure economic goals, the tax law is used to encourage certain business activities and industries. For example, an income tax credit encourages businesses to engage in research and experimentation activities, the energy credits encourage investment in solar and wind energy businesses, and a special deduction for soil and water conservation expenditures related to farm land benefits farmers.

Social goals have also resulted in the adoption of many specific tax provisions. The child and dependent care credit, the earned income credit, and the charitable contribution deduction are examples of tax provisions designed to meet social goals. Social provisions may influence economic activities, but they are written primarily to encourage taxpayers to undertake activities to benefit themselves and society.

An example of a provision that has both economic and social objectives is the provision allowing the gain on the sale of a personal residence up to \$250,000 (\$500,000 if married) to be excluded from taxable income. From a social standpoint, this helps a family afford a new home, but it also helps achieve the economic goal of ensuring that the United States has a mobile workforce.

The use of the income tax as a tool to promote economic and social policies has increased in recent years. Keeping this in mind, the beginning tax student can better understand how and why the tax law has become so complex.

**1-1b The Tax Cuts and Jobs Act of 2017**

Although the tax laws often change in some way each year, significant overhauls of the tax code are actually quite rare. However, in December 2017, The Tax Cuts and Jobs Act or TCJA (PL 115-97) was signed into law. For budgetary reasons, many of the provisions of the tax law are set to expire over the next decade. Many of the more important expiring provisions are listed below along with the chapter in this textbook in which they are discussed.

**Summary of Major Tax Provisions Scheduled to Expire**

<b>TCJA Provision</b>	<b>Expires</b>	<b>Chapter</b>
Reduction of individual tax rates	2025	1
Increased standard deduction	2025	1
Suspension of personal exemptions	2025	1
Qualified business income deduction	2025	4
Suspension of itemized deduction phase-out	2025	5
Temporary cap on state and local taxes	2025	5
Suspension of miscellaneous itemized deductions subject to 2 percent floor	2025	5
Suspension of moving expense deduction	2025	5
Reduced limits on mortgage interest deduction	2025	5



TCJA Provision	Expires	Chapter
Restrictions on personal casualty losses	2025	5
Increased AMT exemption and phase-out	2025	6
Changes to kiddie tax	2025	6
Increased child tax credit	2025	7
100 percent bonus depreciation	Phases out starting 2023	8

It remains uncertain if these provisions will be either extended or made permanent; however, when appropriate, the textbook includes background on the pre-TCJA law in the event those provisions return.

Also, Form 1040 underwent additional changes since the 2018 design change and a new Form 1040-SR for taxpayers over age 65 has been introduced. As a “forms-based” textbook, the design changes have been implemented throughout the textbook.

Most taxpayers know they can deduct contributions of cash to qualified charities but may not deduct the value of their time or services. However, taxpayers may be able to deduct mileage (\$0.14 per mile) associated with the provision of services to a qualified charity.

**TAX  
BREAK**

### Self-Study Problem 1.1 *See Appendix E for Solutions to Self-Study Problems*

Which of the following is not a goal of the income tax system?

- Raising revenue to operate the government.
- Providing incentives for certain business and economic goals, such as higher employment rates, through business-favorable tax provisions.
- Providing incentives for certain social goals, such as charitable giving, by allowing tax deductions, exclusions, or credits for selected activities.
- All the above are goals of the income tax system.

## 1-2 REPORTING AND TAXABLE ENTITIES

Under U.S. tax law, there are five basic tax reporting entities. They are individuals, corporations, partnerships, estates, and trusts. The taxation of individuals is the major topic of this textbook; an overview of the taxation of partnerships and corporations is presented in Chapters 10 and 11, respectively. Taxation of estates and trusts is a specialized area not covered in this textbook.

### 1.2 Learning Objective

Describe the different entities subject to tax and reporting requirements.

### 1-2a The Individual

The most familiar taxable entity is the individual. Taxable income for individuals generally includes income from all sources such as wages, salaries, self-employment earnings, rents, interest, and dividends. Most taxpayers will file Form 1040. The Form 1040 has been redesigned again for 2019. A small number of the items that were relegated to Schedules 1 through 6 in 2018 are back on the face of the Form 1040 in 2019 (e.g., capital gains and losses from Schedule D). Although the Form 1040 does not fill an entire page, it also is no longer “postcard” sized. There is a new Form 1040-SR for taxpayers over the age of 65.

Form 1040-SR is almost identical to Form 1040 except for larger print size and some additional disclosure on the standard deduction presented on the face of the form.

The number of schedules has been reduced to three (Schedules 1, 2, and 3) by combining many of the elements of the previous six schedules:

*Schedule Primary Purpose*

- |   |  |
|---|--|
| 1 | Additional forms of income other than wages, interest, dividends, distributions from qualified retirement plans such as IRAs and pensions, Social Security benefits, and capital gains and losses. Schedule 1 also reports many of the deductions for adjusted gross income. |
| 2 | Additional taxes beyond the basic income tax such as the alternative minimum tax, repayments of excess advance premium tax credit, self-employment taxes, and household employment taxes.  |
| 3 | Credits and payments other than withholding including education credits, the credit for child and dependent care expenses, residential energy credit, estimated tax payments, excess Social Security taxes withheld, and the net premium tax credit.                         |

In addition to Schedules 1–3, certain types of income and deductions must be reported on specific schedules that are included with the Forms 1040 or 1040-SR.

*Schedule Primary Purpose*

- |   |   |
|---|---|
| A | Itemized deductions such as medical expenses, certain taxes, certain interest, charitable contributions, and other miscellaneous deductions |
| B | Interest income (over \$1,500) or ordinary dividend income (over \$1,500)   |
| C | Net profit or loss from a sole proprietor trade or business, other than farm or ranch activities  |
| D | Capital gains and losses  |
| E | Rental, royalty, and pass-through income from partnerships, S corporations, estates, and trusts   |
| F | Farm or ranch income  |

These tax forms and schedules and some less common forms are presented in this textbook.

The origin of the Form 1040 has been rumored to be associated with the year 1040 B.C. when Samuel warned his people that if they demanded a king, the royal leader would be likely to require they pay taxes. However, in the early 1980s, the then-Commissioner of the IRS, Roscoe Eggers indicated that the number was simply the next one in the control numbering system for federal forms in 1914 when the form was issued for taxpayers for the tax year 1913. About 350,000 people filed a 1040 for 1913. All the returns were audited. In 2018, less than 1 percent of the approximately 150 million individual tax returns were audited.



## 1-2b The Corporation

Corporations are subject to the U.S. income tax and must report income annually on Form 1120. Corporations are taxed at a flat rate of 21 percent for all corporations regardless of income level.

Some corporations may elect S corporation status. An S corporation does not generally pay regular corporate income taxes; instead, the corporation's income passes through to the shareholders and is included on their individual returns. S corporations must report tax information annually on Form 1120S. Chapter 11 covers the basics of corporate taxation, including a discussion of S corporations.

## 1-2c The Partnership

The partnership is not a taxable entity; instead it is a reporting entity. Generally, all income or loss of a partnership is included on the tax returns of the partners. However, a partnership must file Form 1065 annually to report the amount of the partnership's total income or loss and show the allocation of the income or loss to the partners. The partners, in turn, report their share of ordinary income or loss on their tax returns. Other special gains, losses, income, and deductions of the partnership are reported and allocated to the partners separately, since these items are given special tax treatment at the partner level. Capital gains and losses, for example, are reported and allocated separately, and the partners report their share on Schedule D of their income tax returns. See Chapter 10 for a discussion of partnerships, including limited partnerships and limited liability companies.

### SUMMARY OF MAJOR TAX FORMS AND SCHEDULES

<i>Form or Schedule</i>	<i>Description</i>
1040	Individual income tax return
Schedule 1	Additional income and adjustments to income
Schedule 2	Additional taxes
Schedule 3	Additional credits and payments
Schedule A	Itemized deductions
Schedule B	Interest and dividend income
Schedule C	Profit or loss from business (sole proprietorship)
Schedule D	Capital gains and losses
Schedule E	Supplemental income and loss (rent, royalty, and pass-through income from Forms 1065, 1120S, and 1041)
Schedule F	Farm and ranch income
1041	Fiduciary (estates and trusts) tax return
1120	Corporate tax return
1120S	S corporation tax return
1065	Partnership information return
Schedule K-1 (Form 1065)	Partner's share of partnership results

All of the forms listed here, and more, are available at the IRS website ([www.irs.gov](http://www.irs.gov)).

**Self-Study Problem 1.2** See Appendix E for Solutions to Self-Study Problems

Indicate which is the most appropriate form or schedule(s) for each of the following items. Unless otherwise indicated in the problem, assume the taxpayer is an individual.

ITEM	Form or Schedule
1. Bank interest income of \$1,600 received by a taxpayer who itemizes deductions	_____
2. Capital gain on the sale of AT&T stock	_____
3. Income from a farm	_____
4. Estate income of \$850	_____
5. Partnership reporting of an individual partner's share of partnership income	_____
6. Salary of \$70,000 for a taxpayer under age 65 who itemizes deductions	_____
7. Income from a sole proprietorship business	_____
8. Income from rental property	_____
9. Dividends of \$2,000 received by a taxpayer who does not itemize deductions	_____
10. Income of a corporation	_____
11. Partnership's loss	_____
12. Charitable contribution deduction for an individual who itemizes deductions	_____
13. Single individual, age 67, with no dependents whose only income is \$18,000 (all from Social Security) and who does not itemize deductions or have any credits	_____

**Learning Objective 1.3**

Apply the tax formula for individuals.

**1-3 THE TAX FORMULA FOR INDIVIDUALS**

Individual taxpayers calculate their tax in accordance with a tax formula. Understanding the formula is important, since all tax determinations are based on the result. The formula is:

$$\begin{aligned}
 & \text{Gross Income} \\
 & - \text{Deductions for Adjusted Gross Income} \\
 & = \text{Adjusted Gross Income} \\
 & - \text{Greater of Itemized Deductions or the Standard Deduction} \\
 & - \text{Qualified Business Income Deduction} \\
 & = \text{Taxable Income} \\
 & \times \text{Tax Rate (using appropriate tax tables or rate schedules)} \\
 & = \text{Gross Income Tax Liability and Additional Taxes} \\
 & - \text{Tax Credits and Prepayments} \\
 & = \text{Tax Due or Refund}
 \end{aligned}$$

The IRS released data in mid-2019 that reflects 2018 individual tax returns filed by mid-May (any extended but unfiled tax returns are not included). The data show that on average, taxpayers had lower effective tax rates than in 2017 for all income brackets. Taxpayers with incomes over \$1 million represented less than 1 percent of the returns filed, about 7 percent of the taxable income, and about 14 percent of the tax liability.



### 1-3a Gross Income

The calculation of taxable income begins with gross income. Gross income includes all income, unless the tax law provides for a specific exclusion. The exclusions from gross income are discussed in Chapter 2. Gross income from wages, interest, dividends, pensions, Social Security, and capital gains and losses are reported directly on Form 1040 (interest and dividends and capital gains and losses may first flow through Schedules B and D, respectively). All other forms of income are reported on Schedule 1.

### 1-3b Deductions for Adjusted Gross Income

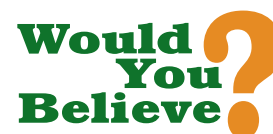
The first category of deductions includes the deductions for adjusted gross income. These deductions include certain trade or business expenses, certain reimbursed employee business expenses paid under an accountable plan, pre-2019 alimony payments, student loan interest, the penalty on early withdrawal from savings, contributions to qualified retirement plans, and certain educator expenses. Later chapters explain these deductions in detail. Deductions for gross income are reported on Schedule 1.

### 1-3c Adjusted Gross Income (AGI)

The amount of adjusted gross income is sometimes referred to as the “magic line,” since it is the basis for several deduction limitations, such as the limitation on medical expenses. A taxpayer’s adjusted gross income is also used to determine limits on certain charitable contributions and contributions to certain individual retirement accounts.

Talk Show Host Stephen Colbert’s Tax Tip: Be extremely wealthy...all kinds of breaks for guys like that!

*Colbert Report, April 3, 2006*



### 1-3d Standard Deduction or Itemized Deductions

Itemized deductions are personal expense items that Congress has allowed as tax deductions. Included in this category are medical expenses, certain interest expenses, certain taxes, charitable contributions, certain casualty losses, and a small number of miscellaneous items. Taxpayers should itemize their deductions only if the total amount exceeds their standard deduction amount. The following table gives the standard deduction amounts for 2019.

<i>Filing Status</i>	<i>Standard Deduction</i>
Single	\$ 12,200
Married, filing jointly	24,400
Married, filing separately	12,200
Head of household	18,350
Qualifying widow(er)	24,400

Taxpayers who are 65 years of age or older or blind are entitled to an additional standard deduction amount. For 2019, the additional standard deduction amount is \$1,650 for unmarried taxpayers and \$1,300 for married taxpayers and surviving spouses. Taxpayers who are both 65 years of age or older and blind are entitled to two additional standard deduction amounts. See LO 1.7 for a complete discussion of the basic and additional standard deduction amounts.

### 1-3e Exemptions

Prior to the TCJA, taxpayers received a deduction called an exemption for themselves, spouse (if married filing jointly), and dependents. Exemptions were suspended by the TCJA starting in 2018. The suspension is scheduled to expire at the end of 2025.

### 1-3f The Gross Tax Liability

A taxpayer's gross tax liability is obtained by reference to the tax table or by use of a tax rate schedule. Tax credits and prepayments are subtracted from gross tax liability to calculate the net tax payable to the government or the refund to the taxpayer.

## TAX BREAK

Taxpayers may provide information with their individual tax return authorizing the IRS to deposit refunds directly into their bank account. Taxpayers with a balance due may also pay their tax bill with a credit card, subject to a fee.

### Self-Study Problem 1.3 *See Appendix E for Solutions to Self-Study Problems*

Bill is a single taxpayer, age 27. In 2019, his salary is \$29,000 and he has interest income of \$1,500. In addition, he has deductions for adjusted gross income of \$2,200 and he has \$6,500 of itemized deductions. Calculate the following amounts:

- |  |          |
|--|----------|
| 1. Gross income                                    | \$ _____ |
| 2. Adjusted gross income                           | \$ _____ |
| 3. Standard deduction or itemized deduction amount | \$ _____ |
| 4. Taxable income                                  | \$ _____ |

### Learning Objective 1.4

Identify individuals who must file tax returns.

### 1-4 WHO MUST FILE

Several conditions must exist before a taxpayer is required to file a U.S. income tax return. These conditions primarily relate to the amount of the taxpayer's income and the taxpayer's filing status. Figures 1.1 through 1.3 summarize the filing requirements for taxpayers in 2019. If a taxpayer has any nontaxable income, the amount should be excluded in determining whether the taxpayer must file a return.

Taxpayers are also required to file a return if they have net earnings from self-employment of \$400 or more, or owe taxes such as Social Security taxes on unreported tips. When a taxpayer is not required to file but is due a refund for overpayment of taxes, a return must be filed to obtain the refund.

A taxpayer who is required to file a return should mail the return to the appropriate IRS Campus Processing Site listed on the IRS website ([www.irs.gov](http://www.irs.gov)) or electronically file the return as discussed in LO 1.10. Generally, individual returns are due on the fifteenth day of the fourth month of the year following the close of the tax year. For a calendar year individual taxpayer, the return due date is generally April 15. If the 15th falls on a weekend or holiday, returns are due the next business day. However, there are two exceptions: (1) In Maine and Massachusetts, Patriots' Day is celebrated on the third Monday of April. When Patriots' Day is on April 15 or the first business day after April 15, the tax filing deadline is deferred for an additional day for residents of Maine and Massachusetts. (2) The second exception is a result of Emancipation Day, a holiday observed in the District of Columbia.