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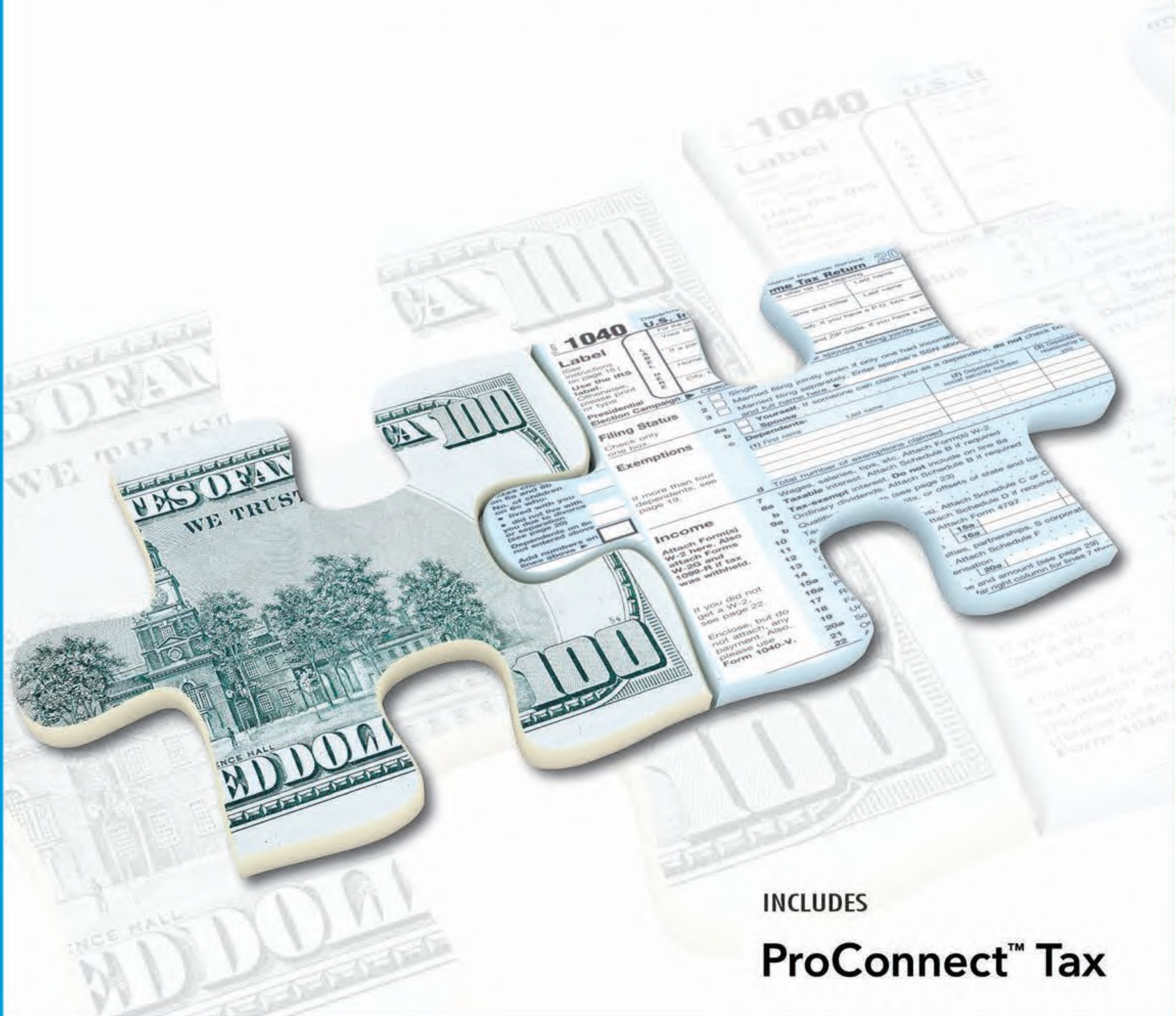
INCOME TAX Fundamentals 2022

WHITTENBURG | GILL



INCLUDES

ProConnect™ Tax

2022 Income Tax FUNDAMENTALS

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San Diego State University

CENGAGE

Australia • Brazil • Canada • Mexico • Singapore • United Kingdom • United States

CENGAGE

***Income Tax Fundamentals,* 40th Edition**
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CONCISE, CURRENT, & PRACTICAL!

Income Tax Fundamentals' Winning Forms Approach Is Time-Tested

Income Tax Fundamentals 2022 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* follows the Form 1040 and supporting Schedules 1 through 3 and A through E. Every attempt to align the concepts with the schedules has been made so students can follow from the detailed form or worksheet to the schedule and eventually to Form 1040.

ProConnect™ Tax

Each individual tax form required to complete the problems in the textbook is included within ***Income Tax Fundamentals*** and within the complimentary ProConnect Tax software. ProConnect Tax is an industry-leading tax preparation software that is hosted on the cloud and provides robust tax content and easy navigation. The ProConnect Tax website offers community and knowledge-based content, view alerts, and FAQ articles. All of the 2021 individual income tax return problems in the textbook may be solved using the ProConnect Tax 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

Many Changes to Tax Law

2021 was another big year for tax law changes. In late 2020, the Consolidated Appropriations Act 2021 was passed, which introduced a number of significant tax law changes. These included the addition of the second economic incentive payment of $600, and the related recovery rebate credit, an expansion of the educator's expense deduction, and the extension of a number of programs aimed at the economic environment brought on by the COVID-19 pandemic—including such programs as the employee retention credit and the sick and family leave credits. Some permanent changes, such as the 7.5% floor on medical expense deductions and repeal of the tuition deduction, were also enacted.

In March of 2021, the American Rescue Plan Act of 2021 was passed. This bill included the third round of economic incentive payments ($1,400) and a number of expansions of credits and deductions related to individual credits that expire at the end of 2021. For example, temporary increases were made to the child tax credit and the child and dependent care credit for 2021 only. All of these changes are included in this edition, and any temporary 2021 versions are denoted as such so that instructors and students can understand the current law and the law that is likely to apply after 2021.

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. Information that is extraneous to the problem is included to encourage students to use analytical and critical-thinking skills to deal with less structured problems.

Additions to Content

This edition contains coverage of the 2020 COVID-related provisions that have the potential to affect 2021 and beyond and introduces a number of tax law changes associated with the myriad of new tax law passed in late 2020 and early 2021. In most situations, the temporary provisions related to 2021 only, and the law that is in place as these provisions expire is also presented.

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 (Forms W-2, 1099, etc.), current COVID-related events, and 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

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 a 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:** End-of-chapter homework is 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:** Provides online assessment.
- CengageNOWv2's **Adaptive Study Plan:** Complete with quizzes, an eBook, and more, it is designed to provide assistance for students who need 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 ProConnect 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 various question types. 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.**

Key Terms

Key Terms with page references are located at the end of all of the chapters and reinforce the important tax terms introduced and discussed 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, located on the instructor companion website: **www.cengage.com/login**, contains detailed solutions to the end-of-chapter problems in the textbook. The solutions for the Additional Comprehensive Problems 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, ProConnect Tax software solutions and instructions, PowerPoints, and more: **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**. 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 2022 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 in Appendix E, 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 and federal tax rate schedule.

MARRIED FILING JOINTLY OR QUALIFYING WIDOW(ER)

$0	$19,900	10% of taxable income *
$19,900	$81,050	$1,990.00 + 12% of the excess over $19,900 *
$81,050	$100,000	$9,328.00 + 22% of the excess over $81,050 *
$100,000	$172,750	$9,328.00 + 22% of the excess over $81,050
$172,750	$329,850	$29,502.00 + 24% of the excess over $172,750
$329,850	$418,850	$67,206.00 + 32% of the excess over $329,850
$418,850	$628,300	$95,686.00 + 35% of the excess over $418,850
$628,300		$168,993.50 + 37% of the excess over $628,300

MARRIED FILING SEPARATELY

$0	$9,950	10% of taxable income *
$9,950	$40,525	$995.00 + 12% of the excess over $9,950 *
$40,525	$86,375	$4,664.00 + 22% of the excess over $40,525 *
$86,375	$100,000	$14,751.00 + 24% of the excess over $86,375 *
$100,000	$164,925	$14,751.00 + 24% of the excess over $86,375
$164,925	$209,425	$33,603.00 + 32% of the excess over $164,925
$209,425	$314,150	$47,843.00 + 35% of the excess over $209,425
$314,150		$84,496.75 + 37% of the excess over $314,150

HEAD OF HOUSEHOLD

10% of tax…

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 st… …understand the calculation of tax according to filing

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

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Real-World Applications Keep Students Engaged

- 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.

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?

ILYA AKINSHIN/Shutterstock.com; Zhukov Oleg/Shutterstock.com

- 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.

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

Would You Believe?

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

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

New Tax Law!

The CARES Act allows higher education institutions to support students by using emergency financial aid grants which may be used for unexpected expenses, unmet financial need, or expenses related to the disruption of campus operations on account of the COVID-19 pandemic, such as unexpected expenses for food, housing, course materials, technology, health care, or childcare. These payments are considered grants and are excluded from income.

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, ProConnect Tax or alternative tax preparation software. The problem evolves with each succeeding chapter's content, allowing students to build on their comprehension of various tax topics.
  - Additional Comprehensive Tax Return Problems are located in Appendix D.

Digital Tools Enhance Student Understanding

CENGAGENOWv2

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 ProConnect Tax software, flashcards, and much more. The student companion website offers—*at no additional costs*—study resources for students. Go to **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.

ProConnect™ Tax

ProConnect Tax access is included with each textbook. A detailed reference lab guide will help the student use the tax software for solving end-of-chapter problems.

For students who are new to the ProConnect Tax software 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 Romanelli/Tetra images/Getty Images

Note to Students: Maximize Your Reading Experience

This textbook 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 the online tax preparation software or hand preparation. The popular software, ProConnect Tax, is available with the textbook. Helpful tips for using ProConnect Tax 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 eleven chapters. A student guide to ProConnect Tax is provided at the companion website. Your college may offer additional tax preparation software, but remember that you can always prepare the solutions manually on the textbook-provided tax forms, schedules and worksheets located conveniently in one place in Appendix F.

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

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 always obvious nor easy. 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 In 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 served 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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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)
U.S. Individual Income Tax Return **2021** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status Check only one box. ☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW) LO 1.5
If you checked the MFS box, enter the name of your 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** 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**
City, town, or post office. If you have a foreign address, also complete spaces below. State ZIP code		
Foreign country name Foreign province/state/county	Foreign postal code	

LO 1.8

At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? ☐ **Yes** ☐ **No**

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, 1.7

Age/Blindness **You:** ☐ Were born before January 2, 1957 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1957 ☐ Is blind

Dependents (see instructions): If more than four dependents, see instructions and check here ▶ ☐

(1) First name	Last name	(2) Social security number	(3) Relationship to you	(4) ✔ if qualifies for (see instructions): Child tax credit	Credit for other dependents
				☐	☐
				☐	☐
				☐	☐
				☐	☐

Attach Sch. B if required.

1	Wages, salaries, tips, etc. Attach Form(s) W-2			1	LO 2.2
2a	Tax-exempt interest	2a	LO 2.10	2b b Taxable interest	LO 2.9
3a	Qualified dividends	3a	LO 2.9	3b b Ordinary dividends	LO 2.9
4a	IRA distributions	4a	LO 5.3	4b b Taxable amount	LO 5.3
5a	Pensions and annuities	5a	LO 2.7	5b b Taxable amount	LO 2.7
6a	Social security benefits	6a	LO 2.16	6b b Taxable amount	LO 2.16
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			7	LO 4.1 to 4.6
8	Other income from Schedule 1, line 10			8	Sch. 1
9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** ▶			9	
10	Adjustments to income from Schedule 1, line 26			10	Sch. 1
11	Subtract line 10 from line 9. This is your **adjusted gross income** ▶			11	
12a	**Standard deduction or itemized deductions** (from Schedule A)	12a	LO 1.8, 5.6 to 5.10		
b	Charitable contributions if you take the standard deduction (see instructions)	12b	LO 5.9		
c	Add lines 12a and 12b			12c	
13	Qualified business income deduction from Form 8995 or Form 8995-A			13	LO 4.10
14	Add lines 12c and 13			14	
15	**Taxable income.** Subtract line 14 from line 11. If zero or less, enter -0-			15	

Standard Deduction for—
- Single or Married filing separately, $12,550
- Married filing jointly or Qualifying widow(er), $25,100
- Head of household, $18,800
- If you checked any box under *Standard Deduction*, see instructions.

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DRAFT AS OF July 21, 2021 DO NOT FILE

Form 1040 (2021) Page **2**

16	**Tax** (see instructions). Check if any from Form(s): **1** ☐ 8814 **2** ☐ 4972 **3** ☐			16	LO 1.5, 2.9, 4.4, 6.4
17	Amount from Schedule 2, line 3			17	Sch. 2
18	Add lines 16 and 17			18	
19	Nonrefundable child tax credit or credit for other dependents from Schedule 8812			19	LO 7.1
20	Amount from Schedule 3, line 8			20	Sch. 3
21	Add lines 19 and 20			21	
22	Subtract line 21 from line 18. If zero or less, enter -0-			22	
23	Other taxes, including self-employment tax, from Schedule 2, line 21			23	Sch. 2
24	Add lines 22 and 23. This is your **total tax** ▶			24	
25	Federal income tax withheld from:				
a	Form(s) W-2	25a	LO 2.2, 9.1		
b	Form(s) 1099	25b	LO 9.1		
c	Other forms (see instructions)	25c			
d	Add lines 25a through 25c			25d	
26	2021 estimated tax payments and amount applied from 2020 return			26	LO 9.2
27a	Earned income credit (EIC)	27a	LO 7.2		
	Check here if you had not reached the age of 19 by December 31, 2021, and satisfy all other requirements for claiming the EIC. See instructions ▶ ☐				
b	Nontaxable combat pay election	27b			
c	Prior year (2019) earned income	27c			
28	Refundable child tax credit or additional child tax credit from Schedule 8812	28	LO 7.1		
29	American opportunity credit from Form 8863, line 8	29	LO 7.5		
30	Recovery rebate credit. See instructions	30	LO 1.7		
31	Amount from Schedule 3, line 15	31	Sch. 3		
32	Add lines 27a and 28 through 31. These are your **total other payments and refundable credits** ▶			32	
33	Add lines 25d, 26, and 32. These are your **total payments** ▶			33	

If you have a qualifying child, attach Sch. EIC.

Refund

34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**			34	
35a	Amount of line 34 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐			35a	
▶ b	Routing number ▶ **c** Type: ☐ Checking ☐ Savings				
▶ d	Account number				
36	Amount of line 34 you want **applied to your 2022 estimated tax** ▶	36			

Direct deposit? See instructions.

Amount You Owe

37	**Amount you owe.** Subtract line 33 from line 24. For details on how to pay, see instructions ▶			37	
38	Estimated tax penalty (see instructions) ▶	38			

Third Party Designee

Do you want to allow another person to discuss this return with the IRS? See instructions ▶ ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ | Phone no. ▶ | Personal identification number (PIN) ▶

Sign Here

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.

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, **both** 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		

Joint return? See instructions. Keep a copy for your records.

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ Self-employed
Firm's name ▶			Phone no.	
Firm's address ▶			Firm's EIN ▶	

SCHEDULE 1 (Form 1040)
Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

▶ Attach to Form 1040, 1040-SR, or 1040-NR.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2021
Attachment Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR	**Your social security number**

Part I **Additional Income**

1	Taxable refunds, credits, or offsets of state and local income taxes			1	LO 5.7
2a	Alimony received			2a	LO 2.13
b	Date of original divorce or separation agreement (see instructions) ▶				
3	Business income or (loss). Attach Schedule C			3	Chapter 3
4	Other gains or (losses). Attach Form 4797			4	LO 8.8
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			5	LO 4.7, 4.8
6	Farm income or (loss). Attach Schedule F			6	
7	Unemployment compensation			7	LO 2.15
8	Other income:				
a	Net operating loss	8a	(LO 4.9)		
b	Gambling income	8b	LO 2.1		
c	Cancellation of debt	8c	LO 2.18		
d	Foreign earned income exclusion from Form 2555	8d	(LO 7.6)		
e	Taxable Health Savings Account distribution	8e	LO 5.1		
f	Alaska Permanent Fund dividends	8f			
g	Jury duty pay	8g	LO 2.1		
h	Prizes and awards	8h	LO 2.6		
i	Activity not engaged in for profit income	8i	LO 3.12		
j	Stock options	8j	LO 2.1		
k	Income from the rental of personal property if you engaged in the rental for profit but were not in the business of renting such property	8k	LO 4.7		
l	Olympic and Paralympic medals and USOC prize money (see instructions)	8l	LO 2.6		
m	Section 951(a) inclusion (see instructions)	8m			
n	Section 951A(a) inclusion (see instructions)	8n			
o	Section 461(l) excess business loss adjustment	8o			
p	Taxable distributions from an ABLE account (see instructions)	8p			
z	Other income. List type and amount ▶ Chapter 2	8z			
9	Total other income. Add lines 8a through 8z			9	
10	Combine lines 1 through 7 and 9. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8			10	

Schedule 1 (Form 1040) 2021 Page **2**

Part II Adjustments to Income

11	Educator expenses			11	LO 5.5
12	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106			12	LO 5.5
13	Health savings account deduction. Attach Form 8889			13	LO 5.1
14	Moving expenses for members of the Armed Forces. Attach Form 3903			14	LO 5.5
15	Deductible part of self-employment tax. Attach Schedule SE			15	LO 6.6
16	Self-employed SEP, SIMPLE, and qualified plans			16	LO 5.4
17	Self-employed health insurance deduction			17	LO 5.2
18	Penalty on early withdrawal of savings			18	LO 2.9
19a	Alimony paid			19a	LO 2.13
b	Recipient's SSN ▶				
c	Date of original divorce or separation agreement (see instructions) ▶				
20	IRA deduction			20	LO 5.3
21	Student loan interest deduction			21	LO 5.8
22	Reserved for future use			22	
23	Archer MSA deduction			23	
24	Other adjustments:				
a	Jury duty pay (see instructions)	24a	LO 2.1		
b	Deductible expenses related to income reported on line 8k from the rental of personal property engaged in for profit	24b			
c	Nontaxable amount of the value of Olympic and Paralympic medals and USOC prize money reported on line 8l	24c			
d	Reforestation amortization and expenses	24d			
e	Repayment of supplemental unemployment benefits under the Trade Act of 1974	24e			
f	Contributions to section 501(c)(18)(D) pension plans	24f			
g	Contributions by certain chaplains to section 403(b) plans	24g			
h	Attorney fees and court costs for actions involving certain unlawful discrimination claims (see instructions)	24h			
i	Attorney fees and court costs you paid in connection with an award from the IRS for information you provided that helped the IRS detect tax law violations	24i			
j	Housing deduction from Form 2555	24j			
k	Excess deductions of section 67(e) expenses from Schedule K-1 (Form 1041)	24k			
z	Other adjustments. List type and amount ▶	24z			
25	Total other adjustments. Add lines 24a through 24z			25	
26	Add lines 11 through 23 and 25. These are your **adjustments to income.** Enter here and on Form 1040 or 1040-SR, line 10, or Form 1040-NR, line 10a			26	

Schedule 1 (Form 1040) 2021

SCHEDULE 2 (Form 1040)
Department of the Treasury
Internal Revenue Service

Additional Taxes

▶ Attach to Form 1040, 1040-SR, or 1040-NR.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2021
Attachment Sequence No. 02

Name(s) shown on Form 1040, 1040-SR, or 1040-NR | **Your social security number**

Part I Tax

1	Alternative minimum tax. Attach Form 6251	1	LO 6.5
2	Excess advance premium tax credit repayment. Attach Form 8962	2	LO 7.4
3	Add lines 1 and 2. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 17	3	

Part II Other Taxes

4	Self-employment tax. Attach Schedule SE			4	LO 6.6
5	Social security and Medicare tax on unreported tip income. Attach Form 4137	5	LO 9.3		
6	Uncollected social security and Medicare tax on wages. Attach Form 8919	6	LO 9.3		
7	Total additional social security and Medicare tax. Add lines 5 and 6			7	
8	Additional tax on IRAs or other tax-favored accounts. Attach Form 5329 if required			8	LO 5.3
9	Household employment taxes. Attach Schedule H			9	LO 6.7
10	Repayment of first-time homebuyer credit. Attach Form 5405 if required			10	
11	Additional Medicare Tax. Attach Form 8959			11	LO 6.8
12	Net investment income tax. Attach Form 8960			12	LO 6.8
13	Uncollected social security and Medicare or RRTA tax on tips or group-term life insurance from Form W-2, box 12			13	
14	Interest on tax due on installment income from the sale of certain residential lots and timeshares			14	
15	Interest on the deferred tax on gain from certain installment sales with a sales price over $150,000			15	
16	Recapture of low-income housing credit. Attach Form 8611			16	

(continued on page 2)

Schedule 2 (Form 1040) 2021 Page 2

Part II Other Taxes *(continued)*

17	Other additional taxes:				
a	Recapture of other credits. List type, form number, and amount ▶	**17a**			
b	Recapture of federal mortgage subsidy. If you sold your home in 2021, see instructions	**17b**			
c	Additional tax on HSA distributions. Attach Form 8889	**17c**	LO 5.1		
d	Additional tax on an HSA because you didn't remain an eligible individual. Attach Form 8889	**17d**			
e	Additional tax on Archer MSA distributions. Attach Form 8853	**17e**			
f	Additional tax on Medicare Advantage MSA distributions. Attach Form 8853	**17f**			
g	Recapture of a charitable contribution deduction related to a fractional interest in tangible personal property	**17g**			
h	Income you received from a nonqualified deferred compensation plan that fails to meet the requirements of section 409A	**17h**			
i	Compensation you received from a nonqualified deferred compensation plan described in section 457A	**17i**			
j	Section 72(m)(5) excess benefits tax	**17j**			
k	Golden parachute payments	**17k**			
l	Tax on accumulation distribution of trusts	**17l**			
m	Excise tax on insider stock compensation from an expatriated corporation	**17m**			
n	Look-back interest under section 167(g) or 460(b) from Form 8697 or 8866	**17n**			
o	Tax on non-effectively connected income for any part of the year you were a nonresident alien from Form 1040-NR	**17o**			
p	Any interest from Form 8621, line 16f, relating to distributions from, and dispositions of, stock of a section 1291 fund	**17p**			
q	Any interest from Form 8621, line 24	**17q**			
z	Any other taxes. List type and amount ▶	**17z**			
18	Total additional taxes. Add lines 17a through 17z			**18**	
19	Additional tax from Schedule 8812			**19**	
20	Section 965 net tax liability installment from Form 965-A	**20**			
21	Add lines 4, 7 through 16, 18, and 19. These are your **total other taxes.** Enter here and on Form 1040 or 1040-SR, line 23, or Form 1040-NR, line 23b			**21**	

SCHEDULE 3 (Form 1040)
Department of the Treasury
Internal Revenue Service

Additional Credits and Payments

▶ Attach to Form 1040, 1040-SR, or 1040-NR.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2021
Attachment Sequence No. **03**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR | **Your social security number**

Part I **Nonrefundable Credits**

1	Foreign tax credit. Attach Form 1116 if required			1	LO 7.6
2	Credit for child and dependent care expenses from Form 2441, line 11. Attach Form 2441			2	LO 7.3
3	Education credits from Form 8863, line 19			3	LO 7.5
4	Retirement savings contributions credit. Attach Form 8880			4	LO 7.9
5	Residential energy credits. Attach Form 5695			5	LO 7.8
6	Other nonrefundable credits:				
a	General business credit. Attach Form 3800	6a			
b	Credit for prior year minimum tax. Attach Form 8801	6b			
c	Adoption credit. Attach Form 8839	6c	LO 7.7		
d	Credit for the elderly or disabled. Attach Schedule R	6d			
e	Alternative motor vehicle credit. Attach Form 8910	6e	LO 7.8		
f	Qualified plug-in motor vehicle credit. Attach Form 8936	6f	LO 7.8		
g	Mortgage interest credit. Attach Form 8396	6g			
h	District of Columbia first-time homebuyer credit. Attach Form 8859	6h			
i	Qualified electric vehicle credit. Attach Form 8834	6i	LO 7.8		
j	Alternative fuel vehicle refueling property credit. Attach Form 8911	6j			
k	Credit to holders of tax credit bonds. Attach Form 8912	6k			
l	Amount on Form 8978, line 14. See instructions	6l			
z	Other nonrefundable credits. List type and amount ▶ ______	6z			
7	Total other nonrefundable credits. Add lines 6a through 6z			7	
8	Add lines 1 through 5 and 7. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 20			8	

(continued on page 2)

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Part II Other Payments and Refundable Credits

9	Net premium tax credit. Attach Form 8962			**9**	LO 7.4
10	Amount paid with request for extension to file (see instructions)			**10**	LO 9.2
11	Excess social security and tier 1 RRTA tax withheld			**11**	LO 9.3
12	Credit for federal tax on fuels. Attach Form 4136			**12**	
13	Other payments or refundable credits:				
a	Form 2439	**13a**			
b	Qualified sick and family leave credits from Schedule(s) H and Form(s) 7202 for leave taken before April 1, 2021	**13b**	LO 6.6		
c	Health coverage tax credit from Form 8885	**13c**			
d	Credit for repayment of amounts included in income from earlier years	**13d**			
e	Reserved for future use	**13e**			
f	Net section 965 inclusions	**13f**			
g	Credit for child and dependent care expenses from Form 2441, line 10. Attach Form 2441	**13g**	LO 7.3		
h	Qualified sick and family leave credits from Schedule(s) H and Form(s) 7202 for leave taken after March 31, 2021	**13h**	LO 6.6		
z	Other payments or refundable credits. List type and amount ▶	**13z**			
14	Total other payments or refundable credits. Add lines 13a through 13z			**14**	
15	Add lines 9 through 12 and 14. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 31			**15**	

Schedule 3 (Form 1040) 2021

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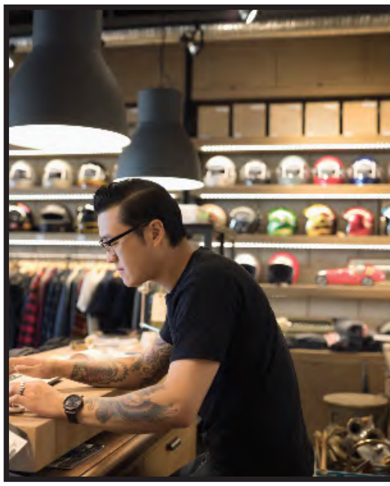

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Questions

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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 Determine the tax impact of the economic impact payment and the recovery rebate credit.

LO 1.8 Calculate the correct standard or itemized deduction amount for taxpayers.

LO 1.9 Compute basic capital gains and losses.

LO 1.10 Access and use various Internet tax resources.

LO 1.11 Describe the basics of electronic filing (e-filing).

OVERVIEW

This 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 of the steps required for completion of a basic Form 1040. There is also 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 provided. 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 contributions 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.

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?

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

1-2 REPORTING AND TAXABLE ENTITIES

1.2 Learning Objective

Describe the different entities subject to tax and reporting requirements.

Under U.S. tax law, there are five basic tax reporting entities: 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.

1-2a 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 individual taxpayers file either Form 1040, or for taxpayers ages 65 or older, Form 1040-SR. The Forms 1040 and 1040-SR are organized so that most taxpayers may only need to use that particular form. Items such as wages, certain interest and dividends, and common deductions and credits are reported directly on the Forms 1040 and 1040-SR. Less common items are reported on a series of supplemental schedules first and then totals from those schedules are carried to the Forms 1040 and 1040-SR.

Three supplemental schedules, Schedules 1, 2 and 3, are used for additional income and deductions, supplemental taxes, and other credits.

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, along with 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.

Would You Believe?

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 2020, 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

Form or Schedule	*Description*
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**).

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 contributions 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	______

1-3 THE TAX FORMULA FOR INDIVIDUALS

1.3 Learning Objective

Apply the tax formula for individuals.

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

  Gross Income
− Deductions for Adjusted Gross Income
= Adjusted Gross Income
− Greater of Itemized Deductions or the Standard Deduction
− Qualified Business Income Deduction
= Taxable Income
× Tax Rate (using appropriate tax tables or rate schedules)
= Gross Income Tax Liability and Additional Taxes
− Tax Credits and Prepayments
= Tax Due or Refund

According to the 2020 Comprehensive Taxpayer Attitude Survey, 86 percent of American taxpayers continue to say that it is "not at all" acceptable to cheat on taxes. Ninety-four percent agree that it is every American's civic duty to pay their fair share of taxes. However, about 30 percent of taxpayers do not trust the IRS to fairly enforce the tax laws and to help taxpayers understand their tax obligations. Trust is especially lower among the more educated and high-income taxpayers.

Would You Believe?

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.

Would You Believe?

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 2021.

Filing Status	*Standard Deduction*
Single	$ 12,550
Married, filing jointly	25,100
Married, filing separately	12,550
Head of household	18,800
Qualifying widow(er)	25,100

Taxpayers who are 65 years of age or older or blind are entitled to an additional standard deduction amount. For 2021, the additional standard deduction amount is $1,700 for unmarried taxpayers and $1,350 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 1.8 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 calculated by referencing the tax table or by using 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 2021, 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 $__________

1-4 WHO MUST FILE

1.4 Learning Objective

Identify individuals who must file tax returns.

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 2021. 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 electronically file the return or mail the return to the appropriate IRS Campus Processing Site listed on the IRS website (**www.irs.gov**). 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. Emancipation Day is observed on April 16; however, when the 16th is a Saturday, the holiday is celebrated on the prior Friday and when the 16th is Sunday, the holiday is celebrated on the following

FIGURE 1.1 WHO MUST FILE

Chart A—For Most People

IF your filing status is . . .	AND at the end of 2021 you were* . . .	THEN file a return if your gross income** was at least . . .
Single	under 65 65 or older	$12,550 14,250
Married filing jointly***	under 65 (both spouses) 65 or older (one spouse) 65 or older (both spouses)	$25,100 26,450 27,800
Married filing separately	any age	$5
Head of household	under 65 65 or older	$18,800 20,500
Qualifying widow(er)	under 65 65 or older	$25,100 26,450

**If you were born on January 1, 1957, you are considered to be age 65 at the end of 2021. (If your spouse died in 2021 or if you are preparing a return for someone who died in 2021, see Pub. 501.)*

*****Gross income** means all income you received in the form of money, goods, property, and services that isn't exempt from tax, including any income from sources outside the United States or from the sale of your main home (even if you can exclude part or all of it). Don't include any social security benefits unless (a) you are married filing a separate return and you lived with your spouse at any time in 2021, or (b) one-half of your social security benefits plus your other gross income and any tax-exempt interest is more than $25,000 ($32,000 if married filing jointly). If (a) or (b) applies, see the instructions for lines 6a and 6b to figure the taxable part of social security benefits you must include in gross income. Gross income includes gains, but not losses, reported on Form 8949 or Schedule D. Gross income from a business means, for example, the amount on Schedule C, line 7, or Schedule F, line 9. But, in figuring gross income, don't reduce your income by any losses, including any loss on Schedule C, line 7, or Schedule F, line 9.*

****If you didn't live with your spouse at the end of 2021 (or on the date your spouse died) and your gross income was at least $5, you must file a return regardless of your age.*

FIGURE 1.2

Chart B—For Children and Other Dependents (See *Who Qualifies as Your Dependent*, later.)

If your parent (or someone else) can claim you as a dependent, use this chart to see if you must file a return.
In this chart, **unearned income** includes taxable interest, ordinary dividends, and capital gain distributions. It also includes unemployment compensation, taxable social security benefits, pensions, annuities, and distributions of unearned income from a trust. **Earned income** includes salaries, wages, tips, professional fees, and taxable scholarship and fellowship grants. **Gross income** is the total of your unearned and earned income.

Single dependents. Were you **either** age 65 or older **or** blind?

☐ **No.** You must file a return if **any** of the following apply.
- Your unearned income was over $1,100.
- Your earned income was over $12,550.
- Your gross income was more than the **larger** of—
  - $1,100, or
  - Your earned income (up to $12,200) plus $350.

☐ **Yes.** You must file a return if **any** of the following apply.
- Your unearned income was over $2,800 ($4,500 if 65 or older **and** blind).
- Your earned income was over $14,250 ($15,950 if 65 or older **and** blind).
- Your gross income was more than the **larger** of—
  - $2,800 ($4,500 if 65 or older **and** blind), or
  - Your earned income (up to $12,200) plus $2,050 ($3,750 if 65 or older **and** blind).

Married dependents. Were you **either** age 65 or older **or** blind?

☐ **No.** You must file a return if **any** of the following apply.
- Your unearned income was over $1,100.
- Your earned income was over $12,550.
- Your gross income was at least $5 and your spouse files a separate return and itemizes deductions.
- Your gross income was more than the **larger** of—
  - $1,100, or
  - Your earned income (up to $12,200) plus $350.

☐ **Yes.** You must file a return if **any** of the following apply.
- Your unearned income was over $2,450 ($3,800 if 65 or older **and** blind).
- Your earned income was over $13,900 ($15,250 if 65 or older **and** blind).
- Your gross income was at least $5 and your spouse files a separate return and itemizes deductions.
- Your gross income was more than the **larger** of—
  - $2,450 ($3,800 if 65 or older **and** blind), or
  - Your earned income (up to $12,200) plus $1,700 ($3,050 if 65 or older **and** blind).

FIGURE 1.3

Chart C—Other Situations When You Must File

You must file a return if any of the seven conditions below apply for 2021.	
1.	You owe any special taxes, including any of the following. **a.** Alternative minimum tax. **b.** Additional tax on a qualified plan, including an individual retirement arrangement (IRA), or other tax-favored account. But if you are filing a return only because you owe this tax, you can file **Form 5329** by itself. **c.** Household employment taxes. But if you are filing a return only because you owe this tax, you can file **Schedule H** by itself. **d.** Social security and Medicare tax on tips you didn't report to your employer or on wages you received from an employer who didn't withhold these taxes. **e.** Write-in taxes, including uncollected social security and Medicare or RRTA tax on tips you reported to your employer or on group-term life insurance and additional taxes on health savings accounts. See the instructions for Schedule 2. **f.** Recapture taxes. See the instructions for line 16 and Schedule 2.
2.	You (or your spouse, if filing jointly) received health savings account, Archer MSA, or Medicare Advantage MSA distributions.
3.	You had net earnings from self-employment of at least $400.
4.	You had wages of $108.28 or more from a church or qualified church-controlled organization that is exempt from employer social security and Medicare taxes.
5.	Advance payments of the premium tax credit were made for you, your spouse, or a dependent who enrolled in coverage through the Marketplace. You or whoever enrolled you should have received Form(s) 1095-A showing the amount of the advance payments.
6.	Advance payments of the health coverage tax credit were made for you, your spouse, or a dependent. You or whoever enrolled you should have received Form(s) 1099-H showing the amount of the advance payments.
7.	You are required to include amounts in income under section 965 or you have a net tax liability under section 965 that you are paying in installments under section 965(h) or deferred by making an election under section 965(i).

Monday. In 2022, April 15 is a Friday, Patriots' Day is Monday the 18th and Emancipation Day is Saturday the 16th, thus the filing deadline will be Friday, April 15.

A six-month extension of time to file may be requested on Form 4868 by the April due date. Regardless of the original filing deadline, the extension is until October 15 unless that day falls on a weekend or holiday in which case the extended due date is the following business day. However, all tax due must be paid by the April due date or penalties and interest will apply.

Self-Study Problem 1.4

See Appendix E for Solutions to Self-Study Problems

Indicate by a check mark whether the following taxpayers are *required* to file a return for 2021 in each of the following independent situations:

	Filing Required? Yes	No
1. Taxpayer (age 45) is single with income of $10,000.	_____	_____
2. Husband (age 67) and wife (age 64) have an income of $26,000 and file a joint return.	_____	_____
3. Taxpayer is a college student with a salary from a part-time job of $6,500. She is claimed as a dependent by her parents.	_____	_____
4. Taxpayer has net earnings from self-employment of $4,000.	_____	_____
5. Taxpayers are married with income of $15,900 and file a joint return. They expect a refund of $600 from excess withholding.	_____	_____
6. Taxpayer is a waiter and has unreported tips of $450.	_____	_____
7. Taxpayer is a qualifying widow (age 48) with a dependent son (age 18) and income of $24,800.	_____	_____

Learning Objective 1.5

Determine filing status and understand the calculation of tax according to filing status.

1-5 FILING STATUS AND TAX COMPUTATION

An important step in calculating the amount of a taxpayer's tax liability is the determination of the taxpayer's correct filing status. The tax law has five different filing statuses: single; married filing jointly; married filing separately; head of household; and qualifying widow(er). A tax table that must be used by most taxpayers, showing the tax liability for all five statuses, is provided in Appendix A. The tax table must be used unless the taxpayer's taxable income is $100,000 or more or the taxpayer is using a special method to calculate the tax liability. If taxpayers cannot use the tax table to determine their tax, a tax rate schedule is used. Each filing status has a separate tax rate schedule as presented in Appendix A.

1-5a Single Filing Status

A taxpayer who does not meet the definition of married, qualifying widow(er), or head of household status must file as single. This status must be used by any taxpayer who is unmarried or legally separated from his/her spouse by divorce or separate maintenance decree as of December 31 of the tax year. State law governs whether a taxpayer is married, divorced, or legally separated.

1-5b Married Filing Jointly

Taxpayers are considered married for tax purposes if they are married on December 31 of the tax year. Also, in the year of one spouse's death, the spouses are considered married for the full year. In most situations, married taxpayers pay less tax by filing jointly than by filing separately. Married taxpayers may file a joint return even if they did not live together for the entire year.

TAX BREAK

Head of Household is a filing status that can be difficult to understand but comes with some substantial tax benefits if a taxpayer qualifies. Single parents should carefully analyze their situation since Head of Household provides lower tax rates and higher standard deductions than Single filing status. This benefit is not just limited to single parents. All unmarried taxpayers that maintain a household and provide support for another person should consider whether they qualify for this tax-advantageous status.

1-5c Married Filing Separately

Married taxpayers may file separate returns and should do so if it reduces their total tax liability. They may file separately if one or both had income during the year. If separate returns are filed, both taxpayers must compute their tax in the same manner. For example, if one spouse itemizes deductions, the other spouse must also itemize deductions. Each taxpayer reports his or her income, deductions, and credits and is responsible only for the tax due on their return. If the taxpayers live in a community property state, they must follow state law to determine community income and separate income. The community property states include Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. See Chapter 2 for additional discussion regarding income and losses from community property.

A legally married taxpayer may file as head of household (based on the general filing status rules) if he or she qualifies as an abandoned spouse. A taxpayer qualifies as an abandoned spouse only if *all* of the following requirements are met:

1. A separate return is filed,
2. The taxpayer paid more than half the cost (rent, utilities, etc.) to maintain his or her home during the year,
3. The spouse did not live with the taxpayer at any time in the last 6 months of the year, and
4. For over 6 months during the year the home was the principal residence for a dependent child, stepchild, or adopted child. Under certain conditions, a foster child may qualify as a dependent.

In certain circumstances, married couples may be able to reduce their total tax liability by filing separately. For instance, since some itemized deductions, such as medical expenses and casualty losses, are reduced by a percentage of adjusted gross income (discussed in Chapter 5), a spouse with a casualty loss and low separate adjusted gross income may benefit from filing separately.

1-5d Head of Household

If an unmarried taxpayer can meet special tests or if a married taxpayer qualifies as an abandoned spouse, they are allowed to file as head of household. Head of household tax rates are lower than rates for single or married filing separately. A taxpayer qualifies for head of household status if both of the following conditions exist:

1. The taxpayer was an unmarried or abandoned spouse as of December 31 of the tax year, and
2. The taxpayer paid more than half of the cost of keeping a home that was the principal place of residence of a dependent child or other qualifying dependent relative. An unrelated dependent or a dependent, such as a cousin, who is too distantly related, will not qualify the taxpayer for head of household status. If the dependent is the taxpayer's parent, the parent need not live with the taxpayer. In all cases other than dependent parents, who may maintain a separate residence, the qualifying dependent relative must actually live in the same household as the taxpayer. A divorced parent who meets the above requirements, but has signed an IRS form or a qualifying legal agreement shifting the dependency deduction to his or her ex-spouse, may still file using head of household status.

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.

1-5e Qualifying Widow(er) with Dependent Child

A taxpayer may continue to benefit from the joint return rates for 2 years after the death of a spouse. To qualify to use the joint return rates, the widow(er) must pay over half the cost of maintaining a household where a dependent child, stepchild, adopted child, or foster child lives. After the 2-year period, these taxpayers often qualify for the head of household filing status.

1-5f Tax Computation

For 2021, there are seven income tax brackets (10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent, and 37 percent). Individuals with taxable income below $100,000 are required to use the tax tables presented in Appendix A. Taxpayers with income equal to or more than $100,000 use the tax rate schedules (also presented in Appendix A). An example of the single tax rate schedule is presented below. Certain high-income taxpayers are subject to additional taxes discussed in Chapter 6.

Single Tax Rate Schedule

If taxable income is over–	But not over–	The tax is:
$ 0	$ 9,950	10% of the taxable income
9,950	40,525	$995 + 12% of the excess over $9,950
40,525	86,375	$4,664 + 22% of the excess over $40,525
86,375	164,925	$14,751 + 24% of the excess over $86,375
164,925	209,425	$33,603 + 32% of the excess over $164,925
209,425	523,600	$47,843 + 35% of the excess over $209,425
523,600	---------	$157,804.25 + 37% of the excess over $523,600

The tax rates applicable to net long-term capital gains currently range from 0 percent to 31.8 percent depending on the taxpayer's tax bracket and the type of capital asset. The calculation of the tax on capital gains is discussed in detail in Chapter 4, and the applicable tax rates are discussed in this chapter.

The tax rates for qualifying dividends, discussed in detail in Chapter 2, range from 0 percent to 23.8 percent in 2021.

EXAMPLE Carol, a single taxpayer, has adjusted gross income of $120,000 and taxable income of $105,000 for 2021. Her tax is calculated using the 2021 tax rate schedule from Appendix A as follows:

$$\$19,221 = \$14,751 + [24\% \times (\$105,000 - \$86,375)]$$ ♦

EXAMPLE Meg is a single taxpayer during 2021. Her taxable income for the year is $27,530. Using the tax table in Appendix A, her gross tax liability for the year is found to be $3,104. ♦

TAX BREAK

Taxpayers considering marriage may be able to save thousands of dollars by engaging in tax planning prior to setting a wedding date. If the couple would pay less in taxes by filing as married rather than as single (which will frequently happen if one spouse has low earnings for the year), they may prefer a December wedding. They can take advantage of the rule that requires taxpayers to file as married for the full year if they were married on the last day of the year. On the other hand, if filing a joint return would cause the couple to pay more in taxes (which frequently happens if both spouses have high incomes), they may prefer a January wedding.

Self-Study Problem 1.5 *See Appendix E for Solutions to Self-Study Problems*

Indicate the filing status (or statuses) in each of the following independent cases, using this legend:

A – Single
B – Married, filing a joint return
C – Married, filing separate returns
D – Head of household
E – Qualifying widow(er)

Case	Filing Status
1. The taxpayers are married on December 31 of the tax year.	________
2. The taxpayer is single, with a dependent child living in her home.	________
3. The taxpayer is unmarried and is living with his girlfriend.	________
4. The taxpayer is married and his spouse left midyear and has disappeared. The taxpayer has no dependents.	________
5. The unmarried taxpayer supports her dependent mother, who lives in her own home.	________
6. The taxpayer's wife died last year. His 15-year-old dependent son lives with him.	________

ProConnect™ Tax TIP

In ProConnect, much of the input is controlled by the left-hand margin. Filing status is part of Client Information under the General heading. By clicking on Filing Status, a dropdown appears in the main window to allow the preparer to select the taxpayer's filing status. For married filing jointly and separately statuses, the Live With Spouse box should be checked if it applies.

1-6 QUALIFYING DEPENDENTS

1.6 Learning Objective

Define qualifying dependents.

1-6a Dependents

Prior to 2018, taxpayers were able to deduct approximately $4,000 each for themselves, their spouse (if married filing jointly), and any dependents. The Tax Cuts and Jobs Act of 2017 (TCJA) eliminated the personal and dependency exemptions in lieu of a larger standard deduction; however, dependents remain important for other reasons. For example, head of household filing status, the child tax credit, and the earned income tax credit all require having a qualified dependent. Lastly, the suspension of personal and dependency exemptions is scheduled to expire after 2025 which means standard deduction amounts may be reduced and exemptions may yet return. A dependent is an individual who meets the tests discussed on the following pages to be considered either a *qualifying child* or a *qualifying relative*.

Would You Believe?

The IRS started requiring the disclosure of Social Security numbers for each dependent claimed by a taxpayer to stop dishonest taxpayers from claiming extra dependents or even claiming pets. Before this change, listing phony dependents was one of the most common forms of tax fraud. Reportedly, 7 million dependents disappeared from the tax rolls after Congress required taxpayers to include dependents' Social Security numbers on tax returns.

1-6b Qualifying Child

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

1. **Relationship Test**
   The child must be the taxpayer's child, stepchild, or adopted child, or the taxpayer's brother or sister, half-brother or half-sister, or stepsibling, or a descendant of any of these. Under certain circumstances, a foster child can also qualify. The taxpayer must be older than the child unless the child is permanently disabled.
2. **Domicile Test**
   The child must have the same principal place of abode as the taxpayer for more than half of the taxable year. In satisfying this requirement, temporary absences from the household due to special circumstances such as illness, education, and vacation are not considered.
3. **Age Test**
   The child must be under age 19 or a full-time student under the age of 24. A child is considered a full-time student if enrolled full-time for at least 5 months of the year. Thus, a college senior graduating in May or June can qualify in the year of graduation.
4. **Joint Return Test**
   The child must not file a joint return with his or her spouse. If neither the spouse nor the child is required to file, but they file a return merely to claim a refund of tax, they are not considered to have filed a return for purposes of this test.
5. **Citizenship Test**
   The dependent must be a U.S. citizen, a tax resident of the United States, Canada, or Mexico, or an alien child adopted by and living with a U.S. citizen.
6. **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. Support includes expenditures for items such as food, lodging, clothes, medical and dental care, and education. To calculate support, the taxpayer uses the actual cost of the above items, except lodging. The value of lodging is calculated at its fair rental value. Funds received by students as scholarships are excluded from the support test.

In the event that a child satisfies the requirements of dependency for more than one taxpayer, the following tie-breaking rules apply:

- If one of the individuals eligible to claim the child is a parent, that person will be allowed to claim the dependent.
- If both parents qualify (separate returns are filed), then the parent with whom the child resides the longest during the year prevails. If the residence period is the same or is not ascertainable, then the parent with the highest AGI (Adjusted Gross Income) prevails.
- If no parents are involved, the taxpayer with the highest AGI prevails.

EXAMPLE Bill, age 12, lives in the same household with Irene, his mother, and Darlene, his aunt. Bill qualifies as a dependent of both Irene and Darlene. Since Irene is Bill's mother, she has the right to claim Bill as a dependent. The tie-breaking rules are not necessary if the taxpayer who can claim the dependent does not claim the dependent. Hence, Darlene can claim Bill as a dependent if Irene does not claim him. ♦

In the case of divorced or legally separated parents with children, the ability to claim a qualifying child belongs to the parent with whom the child lived for more than 6 months out of the year. The opportunity to claim the child as a dependent can be shifted to the noncustodial parent if the custodial parent signs IRS Form 8332, and the form is attached to the noncustodial parent's tax return.

Figure 1.4 illustrates the interaction of the qualifying child dependency tests described above.

1-6c Qualifying Relative

A person who is not a qualifying child can be a qualifying relative if the following 5-part test is met. A child of a taxpayer who does not meet the tests to be a qualifying child can still qualify as a dependent under the qualifying relative tests described below.

1. **Relationship or Member of Household Test**
   The individual must either be a relative of the taxpayer or a member of the household. The list of qualifying relatives is broad and includes parents, grandparents, children, grandchildren, siblings, aunts and uncles by blood, nephews and nieces, "in-laws," and adopted children. Foster children may also qualify in certain circumstances. If the potential dependent is a more distant relative, additional information is available at the IRS website (**www.irs.gov**). For example, cousins are not considered relatives for this purpose.

In addition to the relatives listed, any person who lived in the taxpayer's home as a member of the household for the entire year meets the relationship test. A person is not considered a member of the household if at any time during the year the relationship between the taxpayer and the dependent was in violation of local law.

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. ♦

2. **Gross Income Test**
   The individual cannot have gross income equal to or above the exemption amount ($4,300 in 2021). Although exemptions are no longer deductible, the exemption amount will continue to be updated by the IRS. Gross income does not include any income exempt from tax (for example, tax-exempt interest or exempt Social Security benefits).
3. **Support Test**
   The dependent must receive over half of his or her support from the taxpayer or a group of taxpayers (see multiple support agreement below). Unlike the gross income test, income exempt from tax and earned by the potential dependent is considered for the support test.
4. **Joint Return Test**
   The dependent must not file a joint return unless it is only to claim a refund of taxes.
5. **Citizenship Test**
   The dependent must meet the citizenship test discussed above.

EXAMPLE A taxpayer has a 26-year-old son with gross income of less than the exemption amount and receives more than half of his support from his parents. The son fails the test to be a qualifying child based on his age, but passes the test to be a dependent based on the qualifying relative rules. ♦

Figure 1.5 illustrates the qualifying relative tests described above.

As long as the dependency tests are met, a person who was born or died during the year, such as a baby born before or on December 31, can be claimed as a dependent. Taxpayers must provide a Social Security number for all dependents.

If a dependent is supported by two or more taxpayers, a multiple support agreement may be filed. To file the agreement, the taxpayers (as a group) must provide over 50 percent of the support of the dependent. Assuming that all other dependency tests are met, the group may give the dependent to any member of the group who provided over 10 percent of the dependent's support.

FIGURE 1.4 **DEPENDENCY TESTS FLOW CHART FOR QUALIFYING CHILD**

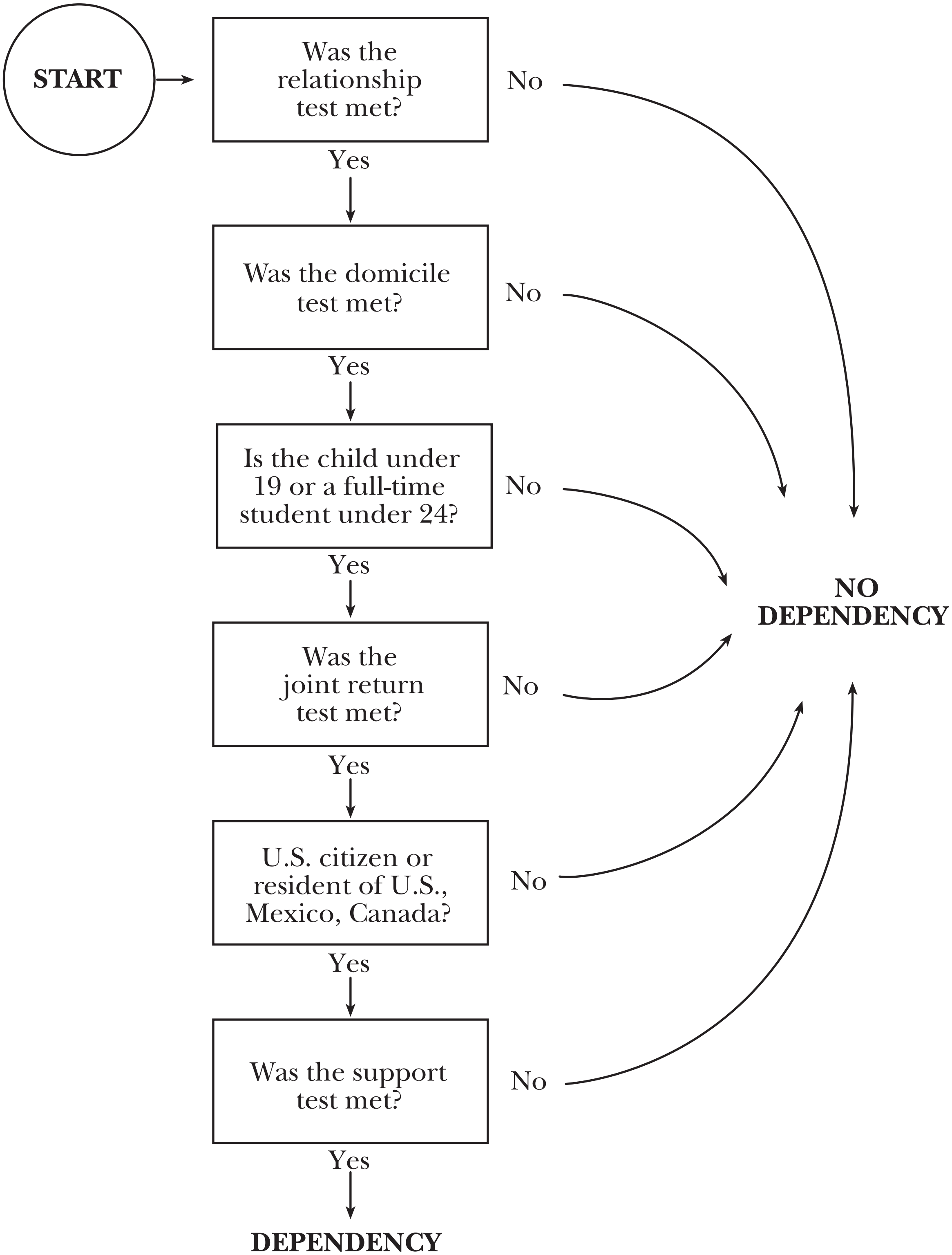
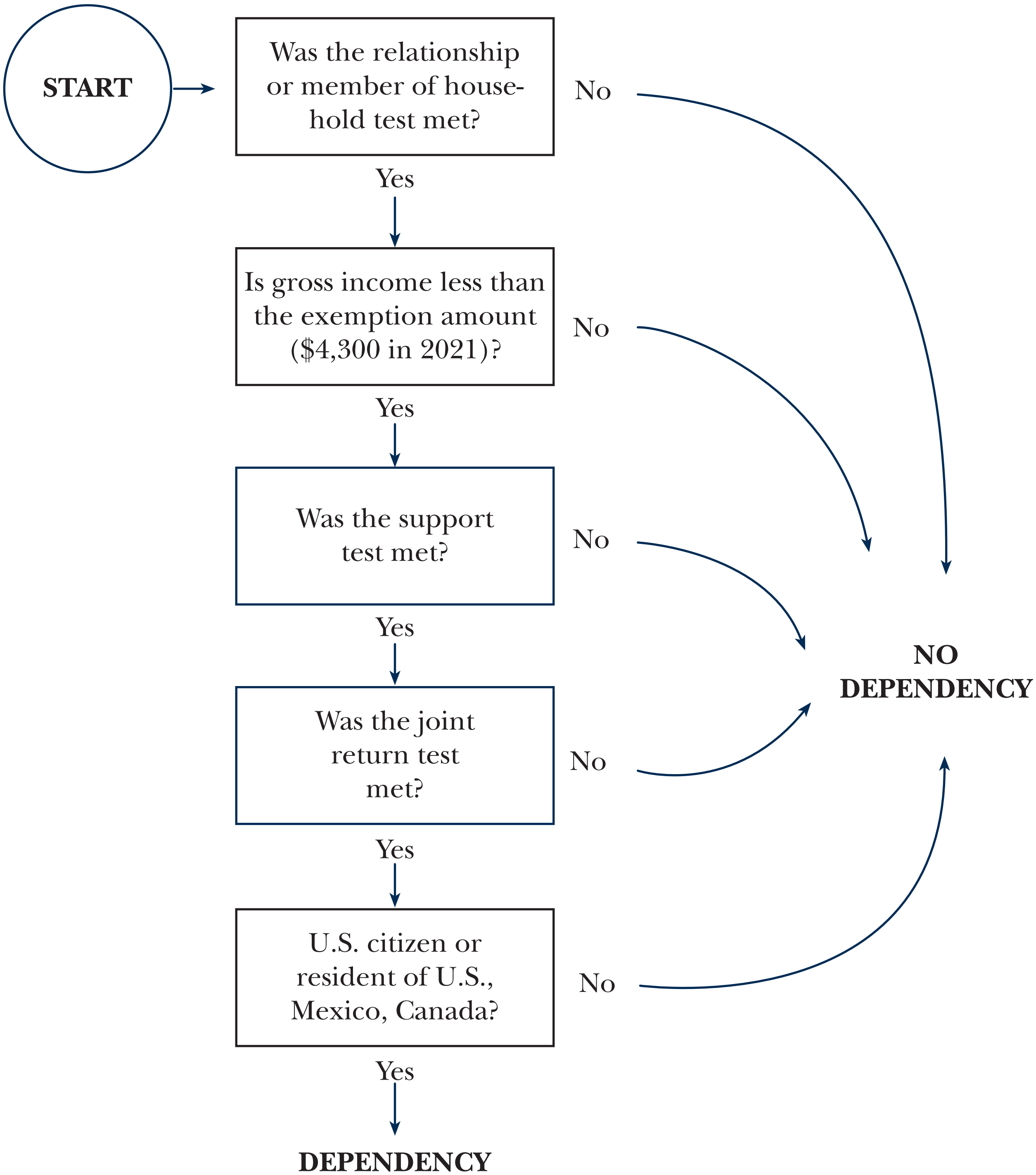


FIGURE 1.5 **DEPENDENCY TESTS FLOW CHART FOR QUALIFYING RELATIVE**



ProConnect™ Tax TIP

Spouse information is entered under Client Information and is just under Taxpayer Information on the left-hand margin. Dependents are a category under General. Be sure and input date of birth and other fields. Typically, the Child Tax Credit and the Earned Income Credit should be set to When Applicable to permit the software to make the correct determination based on input. New dependents can be added by clicking the [+] tab at the top of the main window for Dependents.

1-6d Credits for Children and Other Dependents

Although deductions for personal exemptions are no longer permitted from 2018 through 2025, dependent status is important for claiming a number of individual tax credits such as the child tax credit, the credit for other dependents, and the earned income tax credit. Many of these tax credits are covered in Chapter 7; however, due to the relatively large number of taxpayers that are eligible for the child tax credit and the credit for other dependents, an overview is provided here.

A tax credit differs from a tax deduction. A tax deduction serves to lower the taxable income of the taxpayer.

EXAMPLE Emily's adjusted gross income is $50,175. She is eligible for a $12,550 standard deduction. This lowers her taxable income to $37,625. If Emily is single, her 2021 tax liability is $4,316. ♦

A tax credit lowers the tax liability dollar for dollar. A credit is generally more advantageous than a deduction.

EXAMPLE Emily (from the previous example) is also eligible for a $500 tax credit. Rather than reduce her taxable income, the tax credit reduces the tax itself to $3,816 ($4,316 − $500). ♦

For 2021, the child tax credit was increased to $3,600 for a child under 6 years of age and $3,000 for a child ages 6 through 17. To qualify for the credit, this child must be a qualifying child and have a Social Security number at the time the tax return is filed.

The credit for other dependents is $500 per dependent. An "other dependent" need not be a child but must qualify as either a qualifying child or qualifying dependent. Additional requirements are covered in Chapter 7.

EXAMPLE Bruce and Demi Mehr have two children, Anna (age 12) and Clark (age 18). Both Anna and Clark qualify as qualifying children under the dependent rules. Assuming all other requirements are met, the Mehrs may claim a $3,000 child tax credit for Anna and a $500 other dependent credit for Clark (as he is not under age 18). ♦

In 2021, certain taxpayers may receive an advance payment on their child tax credit during the second half of 2021. The IRS will report the advance payments of the child tax credit on Letter 6419. Additional requirements and a detailed explanation of advance payments of the child tax credit are covered in Chapter 7.

ProConnect™ Tax TIP

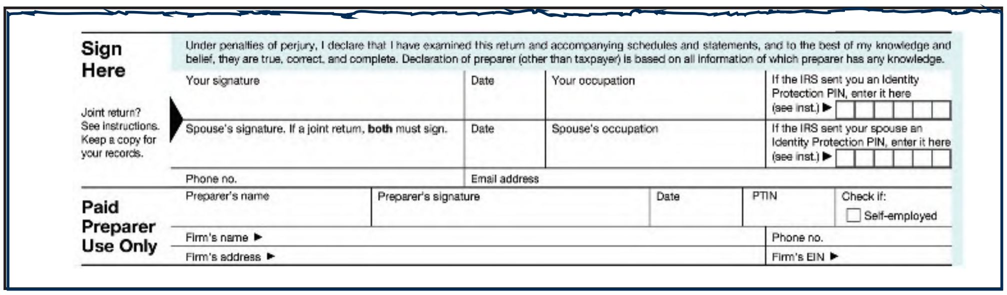
ProConnect is designed to automatically compute the child tax credit and other dependent credit based on the information input in the Dependent window. If no such credit is being shown, it could be due to missing information (for example, birthdate) or the credits were inadvertently suppressed in the Dependent window. The child tax credit and other dependent credit can be overridden under Credits/EIC, Residential Energy, Oth Credits in the left-hand margin, but overriding the system is generally not a good idea.

Self-Study Problem 1.6

See Appendix E for Solutions to Self-Study Problems

Indicate in each of the following situations whether the taxpayer has a dependent in 2021.

	Yes	No
1. Betty and Bob, a married couple, had a new baby in December 2021.	______	______
2. Charlie, age 25, supports his 26-year-old brother, who is not a full-time student. His brother lives with Charlie all year. His brother's gross income is $4,500 from a part-time job.	______	______
3. Donna and her sister support their mother and provide 60 percent of her support. If Donna provides 25 percent of her mother's support and her sister signs a multiple support agreement, can Donna claim the mother as a dependent?	______	______
4. Frank is single and supports his son and his son's wife, both of whom lived with Frank for the entire year. The son (age 20) and his wife (age 19) file a joint return to get a refund, reporting $2,500 ($2,000 earned by the son) of gross income. Both the son and daughter-in-law are full-time students.	______	______
5. Gary is single and provides $5,000 toward his 19-year-old daughter's college expenses. The remainder of her support is provided by a tax-exempt $9,500 tuition scholarship. The daughter is a full-time student.	______	______
6. Helen is 50 years old and supports her 72-year-old mother, who is blind and has $5,000 of Social Security benefits that are not taxable.	______	______


Sign Here
Joint return? See instructions. Keep a copy for your records.
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.
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, **both** 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
Paid Preparer Use Only
Preparer's name | Preparer's signature | Date | PTIN | Check if: ☐ Self-employed
Firm's name ▶ | Phone no.
Firm's address ▶ | Firm's EIN ▶

ILYA AKINSHIN/Shutterstock.com; Zhukov Oleg/Shutterstock.com.

Would You Sign This Tax Return?

Your clients, Adam and Amy Accrual, have a 21-year-old daughter named April. April is single and is a full-time student studying for her bachelor's degree in accounting at California Poly Academy (CPA) in Pismo Beach, California, where she lives with her roommates year-round. Last year, April worked at a local bar and restaurant four nights a week and made $18,000, which she used for tuition, fees, books, and living expenses. Her parents help April by sending her $300 each month to help with her expenses at college. This is all of the support given to April by her parents. When preparing Adam and Amy's tax return, you note that they claim April as a dependent for tax purposes. Adam is insistent that they can claim April because of the $300 per month support and the fact that they "have claimed her since she was born." He will not let you take April off his return as a dependent. Would you sign the Paid Preparer's declaration (see example above) on this return? Why or why not?

Learning Objective 1.7

Determine the tax impact of the economic impact payment and the recovery rebate credit.

1-7 ECONOMIC IMPACT PAYMENT AND RECOVERY REBATE CREDIT

The economic impact payment (EIP) and recovery rebate credit (RRC) are designed to be integrated actions in response to the economic impact of the COVID-19 pandemic. The EIP is a direct payment to certain taxpayers. Two different EIPs were authorized during 2020 and one additional EIP was authorized during 2021.

Approximate EIP Date	*Taxpayer amount*	*Dependent Amount*
April 2020	$1,200 for taxpayer and $1,200 for spouse if married filing jointly	$500 for a qualifying child under age 17
December 2020	$600 for taxpayer and $600 for spouse if married filing jointly	$600 for a qualifying child
March 2021	$1,400 for taxpayer and $1,400 for spouse if married filing jointly	$1,400 for a qualifying dependent

Although the second 2020 EIP may have been received in 2021, for most taxpayers, the RRC and EIP were to be applied to the 2020 tax year and thus the 2021 EIP and RRC are the focus of this section.

The amount of the third EIP is $1,400 ($2,800 for married filing jointly) with an additional $1,400 for each qualifying dependent. Taxpayers that were claimed as a dependent are not eligible for an EIP. The third EIP phases out based on the ratio that the taxpayer's AGI exceeds $150,000 divided by $10,000 for married filing jointly, $75,000 divided by $5,000 for single, and $112,500 divided by $7,500 for head of household. The third EIP phased out much quicker than the previous EIPs and was generally based on information in the 2019 tax return unless a 2020 tax return had been filed by the time the EIP was issued. The IRS was instructed to issue an additional EIP if the taxpayer's 2020 timely filed return indicated a larger EIP would be appropriate.

EXAMPLE Aisha is a head of household taxpayer with a 13-year-old qualifying dependent child. Her 2020 AGI was reported as $115,000.
Aisha's EIP before any phase out would be $2,800 ($1,400 for herself plus $1,400 for the child). However, her income exceeds the phase-out threshold by $2,500 ($115,000 − $112,500). The phase out is $933 ($2,500/$7,500 × $2,800) leaving an EIP of $1,867 ($2,800 − $933).

The first and second EIPs were authorized for qualifying children (with eligibility rules similar to the child tax credit); however, the third EIP was authorized for dependents of the taxpayer, which includes qualifying children and qualifying relatives.

EXAMPLE Tina and Than are married filing jointly taxpayers in 2020 with two children aged 16 and 20 at the end of 2020. Although the older child is not eligible for the child tax credit, both children are qualifying dependents. Tina and Than's 2020 joint AGI was below the phase-out threshold. They would be eligible for and received a $5,600 EIP ($1,400 × 4 persons).

The EIP is not considered gross income. The EIP interacts with the RRC in a very taxpayer favorable way. The RRC is a refundable tax credit much like the Earned Income Credit. The RRC is designed to be the same amount as the EIP (e.g., $1,400 for a single taxpayer), and has the same phase-out limits as the EIP. The way in which the RRC and EIP interact, is that the EIP is considered an advanced refund of the RRC. When the EIP and RRC are equal, they offset and there is no effect on the tax liability of the taxpayer. When the EIP exceeds the RRC, the taxpayer is *not* required to pay back any excess. If, on the other hand, the EIP is less than the RRC, the excess RRC may be claimed as additional refundable credit.

EXAMPLE Helga, a single taxpayer receives a $1,400 EIP in 2021. At the time of preparing her 2021 tax return, Helga calculates a $1,400 RRC. The amounts are equal and offsetting and will not affect her tax payments or tax refund.

EXAMPLE Georgia and Floyd, married filing jointly taxpayers with two dependent children in 2020, received an EIP of $5,600. By the end of 2021, one of the children was no longer a dependent; thus, the RRC claimed on their 2021 tax return was only $4,200. Although the EIP reduces the RRC, the RRC cannot be reduced below $0 and thus, the income tax refund or payment due for 2021 is not affected.

EXAMPLE Florida and James are married taxpayers with one dependent in 2019 and received a $4,200 EIP in 2021. They adopted a child in 2021 and thus finished the year with 2 qualifying children. Their RRC was $5,600. They will reduce the RRC by $4,200 and claim the additional refundable credit of $1,400 on their 2021 tax return.

Taxpayers that received an EIP and were not eligible (e.g., non-residents or an incarcerated taxpayer) are required to return the EIP payment to the IRS.

Self-Study Problem 1.7

See Appendix E for Solutions to Self-Study Problems

What is the net effect of the EIP and RRC on each of the following taxpayers:

1. Mirka and Liam are married and file jointly with AGI of $97,000 in 2021. In 2021 they received an EIP of $4,200 based on their filing status and having a dependent child at the end of 2020.

   $__________

2. Phoebe was a dependent taxpayer in 2020 and had not filed a tax return. In 2021, she failed to request and did not receive an EIP, although she was no longer a dependent and had AGI of $28,000 as a single taxpayer.

   $__________

3. Mahima received a $1,400 EIP in 2021. Due to the birth of her son in 2021, Mahima was classified as a head of household taxpayer with AGI of $47,000.

   $__________

4. Jane and Marshall file jointly in 2021 and claim two dependents. They received a $5,600 EIP in 2021. Jane received a large bonus in 2021 for her efforts during the pandemic and their joint AGI was $155,000 in 2021.

1-8 THE STANDARD DEDUCTION

1.8 Learning Objective

Calculate the correct standard or itemized deduction amount for taxpayers.

The standard deduction was placed in the tax law to provide relief for taxpayers with few itemized deductions. The amount of the standard deduction is subtracted from adjusted gross income by taxpayers who do not itemize their deductions. If a taxpayer's gross income is less than the standard deduction amount, the taxpayer has no taxable income. The 2021 standard deduction amounts are presented below:

Filing Status	*Standard Deduction*
Single	$ 12,550
Married, filing jointly	25,100
Married, filing separately	12,550
Head of household	18,800
Qualifying widow(er)	25,100

The standard deduction amounts were increased significantly by the TCJA. The temporary increases are scheduled to expire after 2025.

1-8a Additional Amounts for Old Age and Blindness

Taxpayers who are 65 years of age or older or blind are entitled to an additional standard deduction amount. For 2021, the additional standard deduction amount is $1,700 for unmarried taxpayers and $1,350 for married taxpayers and qualifying widows or widowers. Taxpayers who are both at least 65 years old and blind are entitled to two additional standard deduction amounts. The additional standard deduction amounts are also available for the taxpayer's spouse, but not for dependents. An individual is considered blind for purposes of receiving an additional standard deduction amount if:

1. Central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or
2. Visual acuity is greater than 20/200 but is limited to a field of vision not greater than 20 degrees.

EXAMPLE John is single and 70 years old in 2021. His standard deduction is $14,250 ($12,550 plus an additional $1,700 for being 65 years of age or older). ♦

EXAMPLE Bob and Mary are married in 2021 and file a joint return. Bob is age 68, and Mary is 63 and meets the test for blindness. Their standard deduction is $27,800 ($25,100 plus $1,350 for Bob being 65 years or older and another $1,350 for Mary's blindness). ♦

1-8b Individuals Not Eligible for the Standard Deduction

The following taxpayers cannot use the standard deduction, but must itemize instead:

1. A married individual filing a separate return, whose spouse itemizes deductions
2. Most nonresident aliens
3. An individual filing a short-period tax return because of a change in the annual accounting period

EXAMPLE Ann and Ed are married individuals who file separate returns for 2021. Ann itemizes her deductions on her return. Ed's adjusted gross income is $12,000, and he has itemized deductions of $900. Ed's taxable income is calculated as follows:

Adjusted gross income	$ 12,000
Itemized deductions	(900)
Taxable income	$ 11,100

Since Ann and Ed file their taxes separately and Ann itemizes her deductions, Ed must also itemize deductions and is not entitled to use the standard deduction amount. ♦

1-8c Special Limitations for Dependents

The standard deduction is limited for the tax return of a dependent. The total standard deduction may not exceed the greater of $1,100 or the sum of $350 plus the dependent's earned income up to the basic standard deduction amount in total (e.g., $12,550 for single taxpayers), plus any additional standard deduction amount for old age or blindness. The standard deduction amount for old age and blindness is only allowed when a dependent files a tax return. It is not allowed to increase the standard deduction of the taxpayer claiming the dependent.

EXAMPLE Penzer, who is 8 years old, earned $17,000 as a child model during 2021. Penzer is claimed as a dependent by his parents on their tax return. Penzer is required to file a tax return, and his taxable income will be $4,450

($17,000 less $12,550, the standard deduction amount). If Penzer had earned only $9,000, his standard deduction would be $9,350 [the greater of $1,100 or $9,350 ($9,000 + $350)], and he would not owe any tax or be required to file a return. ♦

EXAMPLE Geoffrey, who is 4 years old and claimed as a dependent on his parents' tax return, earned $6,500 of interest income on a large bank account left to him by his grandmother. He had no earned income. His standard deduction is $1,100 (the greater of $1,100 or $350). His taxable income will be $5,400 ($6,500 less $1,100, the standard deduction amount). Dependent children may be taxed at their parents' tax rates when their taxable income is made up of unearned income, such as interest. The special "kiddie tax" calculations are covered in Chapter 6. ♦

Self-Study Problem 1.8

See Appendix E for Solutions to Self-Study Problems

Indicate in each of the following independent situations the amount of the standard deduction the taxpayers should claim on their 2021 income tax returns.

_______ 1. Adam is 45 years old, in good health, and single.

_______ 2. Bill and Betty are married and file a joint return. Bill is 66 years old, and Betty is 60.

_______ 3. Charlie is 70, single, and blind.

_______ 4. Debbie qualifies for head of household filing status, is 35 years old, and is in good health.

_______ 5. Elizabeth is 9 years old, and her only income is $3,600 of interest on a savings account. She is claimed as a dependent on her parents' tax return.

_______ 6. Frank and Frieda are married with two dependent children. They file a joint return, are in good health, and both of them are under 65 years of age.

1-9 A BRIEF OVERVIEW OF CAPITAL GAINS AND LOSSES

1.9 Learning Objective

Compute basic capital gains and losses.

When a taxpayer sells an asset, there is normally a gain or loss on the transaction. Depending on the kind of asset sold, this gain or loss will have different tax consequences. Chapter 4 of this textbook has detailed coverage of the effect of gains and losses on a taxpayer's tax liability. Because of the importance of gains and losses to the understanding of the calculation of an individual's tax liability, a brief overview will be discussed here.

The amount of gain or loss realized by a taxpayer is determined by subtracting the *adjusted basis* of the asset from the *amount realized*. Generally, the adjusted basis of an asset is its cost less any depreciation (covered in Chapter 8) taken on the asset. The amount realized is generally what the taxpayer receives from the sale (e.g., the sales price less any cost of the sale). The formula for calculating the gain or loss can be stated as follows:

Gain (or loss) realized = Amount realized − Adjusted basis

Most gains and losses realized are also recognized for tax purposes. Recognized gains and losses are those that are included in the taxpayer's taxable income. The exceptions to this general tax recognition rule are discussed in Chapter 4.

EXAMPLE Lisa purchased a rental house a few years ago for $100,000. Total depreciation to date on the house is $25,000. In the current year she sells the house for $155,000 and receives $147,000 after paying selling expenses of $8,000. Her gain on the sale is $72,000, calculated as follows:

Amount realized ($155,000 − $8,000)	$ 147,000
Adjusted basis ($100,000 − $25,000)	(75,000)
Gain realized	$ 72,000

This gain realized will be recognized as a taxable gain. ♦

1-9a Capital Gains and Losses

Gains and losses can be either *ordinary* or *capital*. Ordinary gains and losses are treated for tax purposes just like other items of income such as salaries and interest, and they are taxed at ordinary rates. Capital gains and losses receive special tax treatment.

A capital gain or loss arises from the sale or exchange of a capital asset. In general, a capital asset is any property (either personal or investment) held by a taxpayer, with certain exceptions as listed in the tax law (see Chapter 4). Examples of capital assets held by individual taxpayers include stocks, bonds, land, cars, boats, and other items held as investments or for personal use. Typical assets that are not capital assets are inventory and accounts receivable.

The tax rates on long-term (held more than 12 months) capital gains are summarized as follows:

Income Level	2021 *Long-term capital gains rate**
Married filing jointly	
$0–$80,800	0%
$80,801–$501,600	15%
>$501,600	20%
Single	
$0–$40,400	0%
$40,401–$445,850	15%
>$445,850	20%
Head of household	
$0–$54,100	0%
$54,101–$473,750	15%
>$473,750	20%
Married filing separately	
$0–$40,400	0%
$40,401–$250,800	15%
>$250,800	20%

*Special higher rates for "high-income" taxpayers are covered in Chapter 6.