CHAPTER 5
ITEMIZED DEDUCTIONS AND OTHER INCENTIVES

Group 1 - Multiple Choice Questions

1. C (Section 5.1)  10. C (Section 5.3)  18. E (Section 5.8)
2. B (Section 5.1)  11. D (Section 5.4)  19. E (Section 5.9)
3. D (Section 5.1)  12. B (Section 5.4)  20. C (Section 5.10)
4. E (Section 5.2)  13. D ($5,000 + 30% of $35,000)  21. C (Section 5.10)
5. A (Section 5.2)  14. A (Section 5.4)  22. D (Section 5.10)
6. D (Section 5.2)  15. D (Section 5.4)  23. B (Section 5.10)
7. C (Section 5.3)  16. C (Section 5.6)  24. B (Section 5.10)
8. E (Section 5.3)  17. D (Section 5.7)  25. D (Section 5.10)
9. B (Section 5.3)  18. E (Section 5.8)

Group 2 – Problems

1. $8,000 = $20,000 – 5,000 – 7,000. Since the pool was prescribed, it qualifies as a medical expense. The increase in value of $7,000 on the house and the reimbursement of $5,000 from the insurance company must be deducted from total expenditures. Although the expenditure is for a capital asset, it can be deducted in full in the year paid for, subject to the deduction of 7.5% of adjusted gross income. (Section 5.1)

3. The medical deduction for the elevator is the amount by which the $10,000 expenditure exceeds the increase in value of the property. Therefore, $10,000 is deductible in the current year as an expense before the 7.5% AGI limitation. For medical purposes such capital expenses are not required to be depreciated. (Section 5.1)

4. $1,800. The $200 refund is picked up in gross income on the tax return. (Section 5.2)

5. 
   Regular years
   Mike: $623 = $2,500 x 91/365
   Jane: $1,877 = $2,500 x 274/365
   Leap years (2004, 2008, etc.)
   $628 = $2,500 x 92/366
   $1,872 = $2,500 x 274/366

7. Mary can deduct the greater of the sales taxes paid or the state income taxes paid, assuming she itemizes deductions. In this case, since her sales taxes, including the sales tax on the automobile, are higher than her state income taxes, she should deduct $4,500 in sales tax on her 2008 Schedule A. (Section 5.2)

8. a. $0
   b. Mary is not entitled to deduct the interest since she is not legally liable for the obligation. (Section 5.3)

9. a. $10,000, limited to Matthew’s net investment income.
   b. Yes. The unused deduction of $20,000 ($30,000 – 10,000) may be carried forward as an investment interest deduction in future years, subject to the investment interest expense limitation. (Section 5.3)
11. a. Qualified residence acquisition debt interest $5,600
b. Qualified home equity debt interest $8,000
   ($12,000/$150,000 x $100,000 (Section 5.3))

12. $5,075, only the mortgage interest is deductible. (Section 5.3)

13. The acquisition debt interest is fully deductible since it is related to debt used to purchase the
residence that is less than $1 million in total. The home equity interest is deductible since up to
$100,000 of home equity debt may be borrowed and used for anything, including college expenses
or vacations, and the interest will still be deductible. Therefore, Mark can deduct $16,500 on his
Schedule A for mortgage interest expense. (Section 5.3)

14. a. $5,000 = $7,000 – 2,000. The $2,000 is the amount of the long-term capital gain that would have
resulted from sale of the property.
   b. Since the painting was not put to a use directly related to the organization’s primary purpose, the
deduction is reduced by the amount of the potential long-term capital gain. (Section 5.4)

16. Richard is allowed to deduct $15,000 on his Schedule A, even though his purchase price for the stock
was only $1,000. His adjusted gross income must be at least $50,000 in order to deduct the full $15,000
since the contribution deduction for long-term capital gain property is limited to 30 percent of adjusted
gross income. Richard would have the option to elect to deduct only the basis of the stock, or $1,000, and
then use the 50 percent AGI limitation, but this is a less advantageous treatment. Any amount which is not
allowed due to the adjusted gross income limitation is carried forward for as long as five years until
there is sufficient income to take the deduction. (Section 5.4)

17. Maureen may take the deduction on her 2007 or her 2008 tax return. For disaster area losses,
taxpayers may elect to treat the losses as a deduction in the year prior to the year of occurrence. (Section 5.5)

18. $2,700 = $8,000 – 100 (floor) – 5,200 (10% of $52,000, adjusted gross income). (Section 5.5)

19. See Form 4684 on pages 109 and 110. (Section 5.5)

20. The instructions for Form 4684 are not reproduced here. (Section 5.5)

21. Kerry can not claim a deduction for a casualty loss related to the totaled auto. The decrease in the
value of the property of $7,500 would be considered the full amount of the casualty loss since the
auto is a personal asset. Since the total amount has been reimbursed by insurance, there is no loss to
claim. (Section 5.5)

22. There is no casualty loss. The destruction of property through progressive deterioration such as rust
is not considered a casualty. (Section 5.5)

23. Yes. Jim is seeking employment in the same trade or business in which he was most recently
employed. The lack of continuity between jobs is not great enough to cause the job hunting expenses to be
nondeductible. (Section 5.6)
25.  
   a. Gross income: $228,000 = $210,000 + $10,000 + $5,000 + $3,000
   b. Adjusted gross income: $224,800 = $228,000 – $3,200
   c. Itemized deduction or standard deduction amount: $23,851
      \[ \frac{($224,800 – $159,950) \times .01 = $649}{\text{AGI}} \]
      $24,500 – $649 = $23,851
   d. Number of exemptions and deduction amount: $17,500 = 5 x $3,500. There is no phase out; the
      of $224,800 is less than the phase-out limit of $239,950.
   e. Taxable income: $183,449 = $224,800 – $23,851 – $17,500 (Section 5.7)

26.  See the Deduction for Exemptions Worksheet–Line 42 on page 111. (Section 5.7)

27.  Moving and packing charges  $5,100
     Travel during the move  900
     Lodging during move  
     \[ \text{Total} = $6,600 \] (Section 5.8)

28.  See Form 3903 on page 113. (Section 5.8)

29.  $11,500; Tuition, room and board, and books. (Section 5.8)

30.  See the answer to Problem 28. (Section 5.8)

31.  Sherry is allowed to claim the costs of moving her household goods and the travel to the new city
     total moving expense deduction of $5,300. The costs of her first month’s rent and restaurant meals
     apartment hunting are considered personal and non-deductible. (Section 5.8)

32.  a. The IRS will consider (1) whether the activity is conducted like a business, (2) the expertise of
     the taxpayer, (3) the time and effort expended, (4) previous success of the taxpayer in similar
     activities, (5) income and loss history from the activity, (6) relationship of income to losses in the activity,
     (7) financial status of the taxpayer, and (8) the elements of personal recreation in the activity.
     b. $6,500 loss = $5,000 – 10,000 – 1,500.
     c. $5,000, loss is limited to the amount of income from the hobby. Of course, the $5,000 of
     bonsai sales would have to be included in gross income while the $5,000 of expenses would be
     miscellaneous itemized deductions subject to the 2 percent of AGI limitation. (Section 5.9)

33. $0; All distributions are used for qualifying expenses. (Section 5.10)

**Group 3 - Comprehensive Problems**

1. See Form 1040 and Schedules A & B on pages 115 to 120.

2A. See Form 1040, Schedules A & B, Form 4684, and Form 3903 on pages 121 to 126.

2B. See Form 1040, Schedules A & B, Form 4684, and Form 3903 on pages 127 to 131.
Group 4 - Cumulative Software Problem

The solution to the Cumulative Software Problem is posted on the Internet site for the text at http://www.cengage.com/taxation/whittenburg.