Appendix E

Practice Set Assignments—Comprehensive Tax Return Problems

PROBLEM 1

John R. and Anne L. Miller are married and live at 13071 Sterling Drive, Aitkin, MN 56431. John is a self-employed insurance claims adjuster (business activity code 524290), and Anne is the dietitian for the local school district. They choose to file a joint tax return each year.

1. John represents several national casualty insurance companies on a contract basis. He operates this business on the cash basis. He is paid a retainer and receives additional compensation if the claims he processes for the year exceed a specified number. As an independent contractor, he is responsible for whatever expenses he incurs. John works out of an office near his home. The office is located at 1202 Motel Road. He shares Suite 326 with a financial consultant, and operating expenses are divided equally between them. The suite has a common waiting room with a receptionist furnished and paid by the landlord. John paid his one-half share of the 2014 expenses as detailed below:

Office rent	$11,600
Utilities (includes telephone and fax)	4,300
Replacement of waiting room furniture on April 22	3,600
Renters' insurance (covers personal liability, casualty, theft)	1,400
Office expense (supplies, postage)	740
New Toshiba copier on February 7	300
Waiting room coffee service (catered)	280
Waiting room magazine subscriptions	90

   For his own business use, John purchased a $2,100 laptop computer on June 17 and a $1,200 Nikon camera on February 5. Except for his vehicle (see item 2 below), John uses the § 179 write-off option whenever possible. John has no expenditures for which he is required to file Form 1099s.

2. On January 2, 2014, John paid $31,000 (including sales tax) to purchase a gently used Toyota Camry that he uses 92% of the time for business. No trade-in was involved, and he did not claim any § 179 expensing. John uses the actual operating cost method to compute his tax deduction. He elects to use the 200%

declining-balance MACRS depreciation method with a half-year convention. His expenses relating to the Camry for 2014 are as follows:

Gasoline	$3,500
Auto insurance	1,700
Interest on car loan	820
Auto club dues	325
Oil changes and lubrication	210
License and registration	190

In connection with his business use of the Camry, John paid $510 for tolls and $350 in fines for traffic violations. In 2014, John drove the Camry 14,352 miles for business and 1,248 miles for personal use (which includes his daily, round-trip commute to work).

3. John handles most claim applications locally, but on occasion he must travel out of town. Expenses in connection with these business trips during 2014 were $930 for lodging and $1,140 for meals. He also paid $610 for business dinners he had with several visiting executives of insurance companies with whom he does business. John's other business-related expenses for 2014 are listed below:

Contribution to H.R. 10 (Keogh) retirement plan	$8,000
Premiums on medical insurance covering self and family (spouse and children)	4,600
Premiums on disability insurance policy (pays for loss of income in the event John is disabled and cannot work)	2,400
State and local occupation fee	450
Birthday gift for receptionist ($25 box of Godiva chocolates plus $3 for gift wrap)	28

4. Anne earns $32,000 working as a registered dietitian for the Aitkin Public School District. The job she holds, manager of the school lunch program, is not classified as full time. Consequently, she is not eligible to participate in the teacher retirement or health insurance programs. Anne's expenses for 2014 are summarized as follows:

Contribution to traditional IRA	$5,500
Job hunting expense	720
Continuing education program	350
Membership dues to the National Association of Dietitians	120
Subscription to *Nutrition Today*	90

In order to work full time and earn a larger salary, Anne applied for a position as chief dietitian for a chain of nursing homes. According to the director of the recruiting service she hired, the position has not yet been filled and Anne is one of the leading candidates. The continuing education program was sponsored by the National Association of Dietitians and consisted of a one-day seminar on special diets for seniors. Anne drove the family Chevrolet Malibu 930 miles on job-related use, out of a total of 8,670 miles driven for the year. The Millers purchased the car on July 11, 2012, for $23,400. Anne uses the automatic mileage method for computing any available deduction for business use of the car.

5. The Millers have supported Gary Simon (Anne's widowed father) for several years, appropriately claiming him as a dependent for tax purposes. On December 27, 2013, Gary suffered a massive stroke. The doctors did everything they could for Gary, but he died in the intensive care unit of Riverwood Hospital on January 8, 2014. In January and February of 2014, the Millers paid the following for Gary: medical expenses of $11,800 not covered by Medicare ($6,000 incurred in 2013 and $5,800 in 2014) and funeral expenses of $15,300. Gary's health insurance was limited to his Medicare coverage because the Millers' medical insurance (see item 3 above) only covered John, Anne, and their sons. Gary's will named Anne as executor and sole heir of his estate.

6. One of the assets that Anne inherited with the transfer of Gary's estate was his house. Upon the advice of the financial consultant who shares office space with John, the Millers decided to convert Gary's home into a furnished rental house. After several minor repairs (e.g., touching up the paint on the interior walls, replacing various window screens, pressure washing the brick exterior, etc.), the property was advertised for rent in the classified section of the local newspaper on March 1, 2014. The repairs cost $720, and the newspaper ad was $360. Based on reconstructed records and appraisal estimates, information about the property is as follows:

	Original Cost	**FMV on 1/8/14**
House	$40,000	$220,000
Land	10,000	50,000
Furniture and appliances	21,000	14,000

7. Gary's former residence was rented almost immediately with occupancy commencing April 1, 2014, under the following terms: one-year lease; $2,400 per month due the first day of the month; first and last month's rent in advance; $2,000 damage deposit; lawn care included but not utilities. The tenant complied with all terms, except the December rent payment was not made until January 1, 2015—the tenant took an extended holiday trip that started on Thanksgiving Day (November 27) through Christmas Day (December 25). Expenses in connection with the property were as follows: property taxes, $2,600; repairs, $320; lawn maintenance, $540; insurance, $1,800; and street paving assessment, $2,100. The property is located at 12120 Lake Road, Aitkin, MN 56431. (Note: If you are using H&R Block software, input 365 in the "days owned" box and in the "days rented" box. Otherwise, the program will apportion the expenses inappropriately.)
8. In early December 2013, a friend advised John to buy stock in Pioneer Aviation, Inc. (PAI). At that time, PAI was in serious financial straits and was headed toward bankruptcy. Nevertheless, according to John's friend, the value of the corporation's underlying assets was such that the shareholders were bound to recover considerably more than the current market price of $.50 per share. Excited at the chance for a "sure" profit, on December 15, 2013, John purchased 20,000 shares for $10,000. In September 2014, the trustee in bankruptcy announced that the stock was worthless and that even some of PAI's preferred creditors would not be paid.
9. On June 14, 2014, the Millers sold 500 shares of Garnet Corporation for $17,500 ($35 per share). They owned 1,000 shares, acquired as follows: 500 shares on November 5, 2013, for $25 a share and 700 shares on April 5, 2014, for $30 a share. The Millers did not instruct their broker as to which shares to sell, so Form 1099–B for this sale reported $12,500 basis for these shares.
10. One month before she died on April 14, 2005, Violet Simon (Anne's mother) gave Anne a coin collection. Based on careful records that Violet kept, the collection had a cost basis of $9,000 and a fair market value of $18,000 at the time Violet passed away. On February 12, 2014, the Miller residence was burglarized and the coin collection was stolen. The Millers filed a claim with the carrier of their homeowner's insurance policy for $24,000 (the current value of the collection). Unfortunately, all they were able to collect was $10,000, which was the maximum pay-out allowed for valuables (e.g., jewelry, antiques) without a special rider attached to the insurance policy.
11. In her will, Violet Simon (see item 10) left Anne a vacant lot on Mississippi Road. Violet had paid $15,000 for the property, and it had a value of $19,000 when she died. Violet had purchased the lot because it was adjacent to a school that she expected to expand. By 2014, it has become clear that the Mississippi Road area of Aitkin is not growing and that no school expansion will take place. Consequently, on July 1, 2014, Anne sold the lot for $19,000. Not included in this price are unpaid property taxes (and interest on the unpaid taxes) of $700 on the lot, which the purchaser assumed and later paid. Form 1099–B did not report the basis of this property.

12. Every year around Christmas, John receives cards from various car repair facilities (including dealerships) expressing thanks for the business referrals and enclosing cash. John has no arrangement, contractual or otherwise, that requires any compensation for the referrals he makes. Concerned about the legality of such "gifts," John consulted an attorney about the matter a few years ago. Without passing judgment on the status of the payors, the attorney found that John's acceptance of the payments does not violate state or local law. John sincerely believes that the payments he receives have no effect on the referrals he makes. During December 2014, John received cards containing $7,200. One additional card containing $900 was delayed in the mail and was not received by John until January 4, 2015.

13. In addition to those previously noted, the Millers' receipts during 2014 are summarized below:

Payments to John for services rendered (as reported on Forms 1099-MISC issued by several payor insurance companies) pursuant to contractual arrangement	$82,000
Income tax refunds for tax year 2013:	
Federal	210
State of Minnesota	90
Interest income (reported on separate Forms 1099-INT):	
State of Minnesota general-purpose bonds	1,400
General Electric corporate bonds	1,100
Certificate of deposit at Aitkin National Bank	900
Qualified dividends (Duke Energy, reported on Form 1099-DIV)	1,200
Proceeds from garage sale (see item 14 below)	9,200
Cash gifts from John's parents	24,000
John's net state lottery losses ($1,000 of winnings reported on Form W2-G; $2,300 of losses)	(1,300)

14. On June 7 and 8, 2014, the Millers held a garage sale to dispose of unwanted furniture, appliances, books, bicycles, clothes, and one boat (including trailer). The estimated basis of the items sold is $25,500. All assets were used by the Millers for personal purposes.

15. Payments made for 2014 expenditures not mentioned elsewhere are as follows:

Medical:	
Copayment portion of medical expenses	$1,300
Dental (orthodontist)	1,200
Taxes:	
State income tax (see item 17 below)	3,456
State sales taxes	1,120
Property taxes on personal residence	3,800
Interest on home mortgage reported on Form 1098	4,200
Charitable contributions	3,600

The Millers' medical insurance does not cover dental services. The Millers pledge contributions of $1,200 per year to their church. In 2014, they paid the pledges for 2013–2015. During 2014, the Millers drove the Malibu 270 miles for medical purposes (e.g., trips to the hospital, doctor and dentist offices) and 320 miles delivering meals to the poor for Meals-on-Wheels, a qualified charity.

16. The Millers have two sons who live with them: Trace and Trevor. Both are full-time students. Trace is an accomplished singer and earned $4,200 during the year performing at special events (e.g., weddings, anniversaries, civic functions). Trace deposits his earnings in a savings account intended to help cover future college expenses. Trevor does not have a job.

17. The Form W-2 Anne receives from her employer reflects wages of $32,000. Appropriate amounts for Social Security and Medicare taxes were deducted. Income tax

withholdings were $1,320 for Federal and $1,056 for state. The Millers made quarterly tax payments of $2,000 for Federal and $600 for state on each of the following dates: April 15, 2014, June 16, 2014, September 15, 2014, and December 29, 2014. None of the Millers hold any foreign financial accounts. Relevant Social Security numbers are noted below:

Name	Social Security Number	Birth Date
John R. Miller	111-11-1111	06/06/1972
Anne L. Miller	123-45-6781	08/14/1973
Gary Simon	123-45-6784	03/12/1934
Trace Miller	123-45-6788	09/13/1997
Trevor Miller	123-45-6789	07/20/1999

Requirements

Prepare an income tax return (with all appropriate forms and schedules) for the Millers for 2014 following these guidelines:

- Make necessary assumptions for information not given in the problem but needed to complete the return.
- The taxpayers are preparing their own return (i.e., no preparer is involved).
- The taxpayers have substantiation (e.g., records, receipts) to support all transactions for the year.
- If any refund is due, the Millers want a refund check sent to them by mail.
- The Millers had itemized deductions from AGI for 2013 of $16,700, of which $1,500 was for state and local income taxes.
- The Millers do not want to contribute to the Presidential Election Campaign Fund.