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ABSTRACT

The course book contains eight lessons designed for military Personnel learning how to properly prepare their U.S. Income Tax returns. The lessons cover the following subjects: requirements for filing returns of income and declaration of estimated tax; exemptions; gross income; exclusions and deductions to arrive at adjusted gross income; percentage standard deduction, low income allowance, and itemized deductions; rental income and depreciation; aliens; and exclusion of earned income from sources outside the U.S., Section 911. For each lesson the course book provides an introduction, lesson objectives, explanations of the various content areas within the lesson, a summary, and a quiz. Appendixes provide quiz solutions, a 1975 Form 1040 road map, dependency exemption charts, and major applicable tax forms. (JR)

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# Course Book

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## U.S. Armed Forces Training income tax law

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Internal Revenue Service

U.S. DEPARTMENT OF HEALTH,  
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## Preface

The program for the United States Armed Forces is intended to furnish a brief summary of the United States income tax law. This course offers a concise compilation of information and reference material.

This publication should not be relied upon as encompassing all facets of the subject presented. Research in other authoritative tax publications may therefore be advisable on the more difficult or unusual problems encountered. In no instance should this publication be cited as authority for a position taken.

### **Please Note:**

The Intertal Revenue Code was amended by the Tax Reduction Act of 1975. The changes made by the Act generally apply only to 1975. The following is a list of the new provisions which apply to individual taxpayers:

1. \$30 exemption credit.
2. Earned income credit.
3. Purchase of new residence credit.
4. Low income allowance increase.
5. Standard deduction increase.
6. Income level increase for the child care deduction (applies in 1976 and later years).

Also the Code was amended by Public Law 93-625 which changed the interest rate charged or paid in connection with deficiencies, etc. from 6% to 9% effective July 1, 1975.

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## Suggested Daily Classroom Schedule

First Day	Hours
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	—
Total	8

Second Day	Hours
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	—
Total	8

Third Day	Hours
Chapter 6 (Rental Income & Depreciation)	1
Chapter 7 (Aliens)	3
Chapter 8 (Section 911)	1
Review	3
	—
Total	8

### The course materials are:

Course Book,  
Your Federal Income Tax—Publication 17  
Federal Income Tax Information for Armed Forces Personnel—  
NAVSO P-1983 .  
Tax Guide for Small Business—Publication 334  
U.S. Tax Guide for Aliens—Publication 519  
Tax Guide for U.S. Citizens Abroad—Publication 54  
Federal Income Tax Forms for 1975

# Chapter 1. Requirements for Filing Returns of Income and Declaration of Estimated Tax

## Introduction

Short Form 1040A is filed without any accompanying schedules. Form 1040 may be filed with one or more of the following schedules if needed:

Schedules A and B, for itemized deductions and for dividends or interest over \$400;

Schedule D, for gains or losses on sales or exchanges of property;

Schedules E and R, for income from pensions, rents, partnerships, estates, small business corporations, and retirement income credit;

Schedule F, for farm income and expenses,

Schedule G, for income averaging.

This chapter discusses the requirements for filing income tax returns and the declaration of estimated tax. Chapters 1-6 and 8 deal only with U.S. citizens. Chapter 7 deals with the tax problems of aliens. Special emphasis is given to military situations. For a broader picture of the filing requirements that pertain to minors, decedents, etc., refer to "Your Federal Income Tax," otherwise known as Publication 17. An explanation of the application of penalties to those areas of noncompliance is also incorporated in this chapter.

## Objectives—Chapter 1

Participants should be able to explain the following concepts:

- (1) Requirements for filing
- (2) Joint vs. separate returns
- (3) Surviving spouse and head-of-household status
- (4) Introduction to Forms 1040, 1040A and 1040X
- (5) Statute of limitations
- (6) Penalties
- (7) Declaration of estimated tax

Applicable forms for this chapter include.

### Form No.

1310 Statement of Claimant to Refund Due Deceased Taxpayer

4868 Application for Automatic Extension of Time to File U.S. Individual Income Tax Return

2688 Application for Extension of Time to File (Resident)

843 Claim

1040 Individual Income Tax Return

1040A Individual Income Tax Return—Short Form

1040X Amended U.S. Individual Income Tax Return

1040-ES Declaration of Estimated Tax for Individuals

2350 Application for Extension of Time for Filing U.S. Income Tax Returns (U.S. Citizen Abroad).

## General Rules for U.S. Citizens

The income level at which an individual must file an income tax return is as follows for taxable year 1975.

Single—under 65	\$2,350
Single—65 or over	3,100
Married—Filing Jointly	3,400
Married—Filing Jointly (one spouse 65 or over)	4,150

Married—Filing Jointly (both spouses 65 or over)	4,900
Married—Filing Separately	750
Dependent taxpayer with unearned income	750
Persons with Income from U.S. Possessions	750
Surviving Spouse	2,650

The income level at which a return must be filed (\$2,350 for individuals who are not married and \$3,400 for married persons filing jointly) is increased by \$750 for each additional personal exemption for age 65 or older to which they are entitled. Exemptions for blindness and dependents do not apply to the filing requirements.

For married couples, these higher filing requirements apply only if they have the same household as their home at the close of the taxable year. They do not apply if either spouse files a separate return or if any other taxpayer is entitled to an exemption for either spouse.

The taxpayer must file a tax return if the gross income level as mentioned above is met or exceeded. This applies in all cases regardless of whether:

(a) the taxpayer's entire tax for the taxable year under consideration has been paid in full or overpaid through amounts withheld by the individual's employer or through direct payments to the Government on a declaration of estimated tax;

(b) the taxpayer's deductions exceed this gross income, and thus no tax liability;

(c) the taxpayer's credits render the return nontaxable; or

(d) the taxpayer is residing at home or abroad.

If the taxpayer receives gross income of less than the amount in the "required to file income level category" he is not required to file a return. However, suppose a new recruit, almost straight out of high school, earns less than his "required to file income level." Since his gross income is less than his "required to file income" he does not have to file a return, but he should file a return in order to recover the taxes withheld from his wages. In this case, a properly executed return Form 1040 or Form 1040A serves as a claim for refund.

A self-employed individual is required to file a tax return if net earnings (synonymous with net profit) from self-employment are \$400 or more, even though gross income is less than his "required to file income level."

## Dependent Taxpayers With Unearned Income

The filing requirement for children under age 19 or full-time students is \$750 if: (1) they can be claimed as dependents of another and (2) they have *unearned income*. The origin of the dependent's unearned income is immaterial. It may come from the yield on inheritances, gifts, trust income, dividends (after the exclusion) or even the savings from the dependent's own earnings. See Chapter 5 for a discussion on "unearned income."

*Note:* If the child or student furnishes more than one half of his own support, or is married and files a joint return, his parents would not be entitled to a personal

exemption for him. Therefore, since he does not qualify as a "dependent," the unearned income rule would not apply. It is important to note that the child or student need not be actually *claimed* as a dependent. The unearned income rule applies if the parent is *entitled* to the exemption regardless of whether he actually claims it.

## What Is "Gross Income" for the Purpose of Determining Who Must File

Although subsequent chapters deal specifically with "gross income," and inclusions and exclusions with regard to "gross income," it is imperative at this point to define "gross income" as it applies to the "required to file income level" test.

"Gross income," for purposes of filing an income tax return, means all wealth which flows to the taxpayer (other than a more return of capital), except income excluded by statutory provisions. Gross income includes income realized in any form, whether in money, property or accommodations. In general, if services are paid for in other than money, the fair market value of the property or services taken in payment must be included in gross income. What constitutes "gross income" may be classified as follows:

(a) *For servicemen*, "gross income" for the purpose of filing an income tax return includes such items as basic pay, incentive pay, special pay, reenlistment bonus, dividend income, interest, annuities, etc.

(b) *For rental property*, "gross income" means gross receipts from rents, that is, before deductions for rental operating expenses.

(c) *For sales or other disposition of property*, "gross income" means the gross selling price, less the cost or adjusted basis of the property sold or otherwise disposed of.

(d) *For a citizen of the United States who claims the exclusion of wages earned outside the United States* because he is a bona fide resident of a foreign country for an entire year or physically present in a foreign country for 510 full days during a period of 18 consecutive months, a tax return must be filed if the required to file income level test is satisfied. In determining whether the test is met, the taxpayer must count such excluded income.

You may have certain civilians (contractors, etc.) working at your base whose incomes are not taxable because of this exclusion. However, if their income, although excludable, exceeds their required to file income level, they, nevertheless, are required to file an income tax return and submit a Form 2555 with it. (This will be covered in Chapter 8 dealing with exclusions.)

## General Information Submitted on a Return

Members of the Armed Forces should indicate their name, social security number, and *permanent home address* on their returns. Suppose the taxpayer is entitled to a refund which he does not wish to be mailed to his permanent home address. In that event, it is suggested that the taxpayer delete his permanent address and enter his current address.

## Presidential Election Campaign Fund

A taxpayer may designate \$1 (if a joint return, \$1 each for husband and wife) of his taxes to the presidential election campaign fund by checking the appropriate box(es) on Forms 1040 or 1040A. Checking the box(es) will not increase the tax or reduce the refund.

## Filing Status

Five filing status categories are listed on page 1 of Forms 1040 and 1040A. These are:

- Single
- Married filing joint return (even if only one had income)
- Married filing separately
- Unmarried Head of Household
- Qualifying widow(er) with dependent child

You are to check the correct box of the taxpayer involved. By ascertaining his appropriate category at the start, you will find it easier to decide upon such tax features as tax tables to use, exemptions allowable, methods of computation, etc. Only one box should be checked on a tax return.

### Single

A single person is one who is unmarried as of the last day of the tax year. A "single" taxpayer may be a bachelor, a person divorced under a final decree, or a person who is legally separated or a widow(er). However, a person separated under an interlocutory decree of divorce is not considered unmarried for this purpose and may not file as a single person.

A taxpayer's status at the close of the year is his status for the year. For example, a person who receives a final decree of divorce on 31 December of a given year is a "single" taxpayer for the entire year.

Certain "single" taxpayers who support dependents may also qualify as "unmarried head of household" or "surviving widow(er)." See the explanations of these categories which follow.

### Married Filing Joint Returns

A husband and wife may file separate returns or one joint return. However, as will be noted in a later discussion on the advantages and disadvantages of filing joint or separate returns, married taxpayers almost always will benefit by filing a joint return instead of filing separate returns.

A joint return must include all the income and deductions of both spouses. Thus, even though the income of one spouse may be less than \$750 and that person would not be required to file a return, this income would have to be included if the couple decided to file a joint return. A joint return may be filed even if one of the spouses has no income during the tax year.

Under no circumstances may one spouse file a separate return to receive a refund of tax on wages withheld if the income is less than \$750 and, at the same time, file a joint return with the other spouse.



## Effects of Death on a Joint Return

If one spouse dies during the taxable year and the surviving spouse does not remarry before the close of the tax year, the surviving spouse can file a joint return with the deceased spouse.

*Note:* As will be studied later, the surviving spouse may also, under certain circumstances, use the joint return tax tables for the two years following the year of death of his or her spouse; an exemption may not, however, be claimed for the deceased spouse in other than the year of death.

If the surviving spouse remarries in the year of death of the other, then the return for the deceased former spouse would have to be a separate return. However, the surviving spouse and the present spouse may file a joint return for such taxable year.

Chapter 3 in Publication 17 discusses in detail the law applicable to the filing of returns involving decedents. The following thoughts are highlighted since they are more important:

(1) When a return is being prepared on behalf of a decedent, after the surname write "deceased."

(2) The gross income requirement for filing a return for a decedent is the same as that for any other taxpayer.

(3) The executor, administrator or legal representative, if one has been appointed, must file the final return and sign the return on behalf of the deceased. If no person has been appointed, the surviving spouse may file the joint return and sign the return adding "Taxpayer and surviving spouse."

(4) If a refund is due, a Form 1310, Statement of Claimant to Refund Due Deceased Taxpayer, must be executed by the person claiming the refund. A copy of the death certificate must accompany the Form 1310.

## Citizenship or Residency

It is most important to know that in order for married taxpayers to be eligible for the tax benefits of joint return filing they must either be citizens or alien residents of the United States during the entire taxable year.

The taxation of aliens is discussed later in the text.

## Problems of Husband and Wife Electing To File a Joint Return

Certain problems are frequently encountered by the average taxpayers electing to file a joint return. These problems should be thoroughly understood in order to determine whether a joint return or separate returns are more advantageous. Some of the most common problems are listed below.

(1) *The determination of the aggregate adjusted gross income, taxable income and credits*—When a husband and wife exercise their statutory rights to file a joint return, they are in effect, regarded as a single taxpayer. The incomes of both are combined in computing the combined "adjusted gross income" (line 15, Form 1040 or line 12, Form 1040A) and the combined "taxable income" (line 47, Form 1040 or line 5, Form 1040A Worksheet). In certain cases, however, separate computations may be necessary to arrive at the correct adjusted gross income. For example, sick-pay exclusions

and dividends received exclusions, if both husband and wife qualify for these exclusions, are to be separately computed.

The credits against their tax liability are also, as a general rule, aggregated. However, separate computations must be employed in those cases where each of the spouses is entitled to the benefits of retirement income credits against the tax liability.

These are but a few examples of specific items which require separate computations to arrive at the combined credits inuring to married taxpayers filing joint returns.

(2) *The liability for any tax and penalties due on such return*—if a joint return is filed each spouse is generally liable:

(a) for the full amount of tax due on such return, regardless of the amount of his or her separate taxable income included therein; and,

(b) for any increase in liability by reason of civil penalties imposed.

*Note:* Chapter 2 in Publication 17 discusses the "innocent spouse" exception to the general rule.

Whether a joint return or separate returns will result in a tax advantage depends upon various factors. In some of the special situations given below, it is to the advantage of the spouses to file a joint return, in others it is to their disadvantage.

## Advantages of Filing a Joint Return

A joint return containing large amounts of gross income generally results in a tax advantage, since the tax based on taxable income is computed at rates which apply to each one-half of the income.

A joint return is advantageous when one spouse had deductions in excess of gross income. The excess deductions of the spouse may be applied against the income of the other spouse.

A joint return may permit a greater deduction for contributions if one spouse has made contributions in excess of the allowable limitation and the other spouse did not use up his or her maximum allowable deduction.

A joint return would be advantageous when the gross income of one spouse is less than \$750, since the other spouse would benefit by the excess of the deduction for the \$750 exemption over the income of such spouse.

## Disadvantages of Filing a Joint Return

If one spouse has a heavy medical expense deduction and a moderate income and the other spouse has a moderate income and no medical expenses, it would ordinarily be to their disadvantage to file a joint return. A smaller adjusted gross income allows a greater medical deduction.

## Conclusion

A military man and his U.S. citizen or resident alien wife will find it more advantageous to file a joint return because the tax rate applicable to a joint return is much more beneficial than that applicable to separate returns and because, as a rule, the medical needs of military personnel and their families are administered at low cost to such personnel.



## Married Filing Separately

Married persons may file separate tax returns if they choose to do so. Each spouse reports his own income, claims his own deductions and exemptions, and computes his tax under rates applicable to married persons who file separate tax returns. Each spouse is liable for any tax due on his return and is entitled to the refund if the tax paid in advance exceeds the tax liability shown on the tax return.

If either spouse had at least \$750 income and the other did not, the spouse who had at least \$750 may file his own separate return while the other need not file. The spouse filing the return must report only his own income. If the spouse not filing had no income and was not the dependent of someone else, then the one filing may claim his spouse's exemption.

### May Separate Returns Be Substituted for a Joint Return or Vice Versa?

Separate returns may be substituted for an original joint return only if they are filed on or before the 15th day of the fourth month following the close of the taxable year. In other words they must be filed before the expiration of the due date of the return (15 April for calendar year taxpayers).

Married taxpayers who elected to file separate returns are permitted to change their election. An amended joint return may be filed within three years from the regular due date of the return, exclusive of any extension of time granted to either spouse.

If a taxpayer was married and entitled to file a joint return at the time of filing a separate return, he and his spouse may subsequently elect to file jointly even though at the time of such election they are legally separated or divorced.

If either spouse has died, the election to change from a separate to a joint return with respect to the decedent can be made only by the executor or administrator.

A joint return may not be substituted for original separate returns if:

(a) either spouse has instituted an action against the Government in any court with respect to his taxes for that year;

(b) either spouse has entered into a closing agreement with respect to that taxable year; or

(c) either spouse has compromised any civil or criminal liabilities for taxes with respect to that year.

## Married Individuals Filing Separate Returns

If a husband and wife file separate Forms 1040 and one elects to itemize deductions the other must also itemize. If one itemizes deductions on Form 1040, the other may not take the Standard Deduction, use the Optional Tax Tables, or file Form 1040A. The spouses must be consistent in their election.

## Married Persons Living Apart

An *abandoned spouse* is not considered married if she (or he) (1) files a separate return and maintains as her home a household which constitutes, for more than one-half of the taxable year, the principal place of abode of her dependent son, daughter, stepson, or step-

daughter for whom she is entitled a dependency exemption for the year, (2) she furnishes more than one-half the cost of maintaining the household and, (3) during the entire taxable year her spouse is not a member of the household.

## Unmarried Head of Household Status

This tax computation results in a lower tax liability than the separate status, but in a higher one than the joint return status. In fact it falls about half-way between these two computations.

To obtain this benefit the taxpayer must meet two requirements.

### Requirement (1)—Marital Status

The taxpayer must be unmarried (or legally separated) on the last day of the tax year. An interlocutory decree of divorce does not give the taxpayer an unmarried status.

If at the end of the tax year the U.S. taxpayer is married to a spouse who was a nonresident alien at some time during the tax year, the U.S. taxpayer is *not* considered married for purposes of this head of household test. However, the nonresident alien spouse does not qualify as a relative or dependent for purposes of Requirement (2) explained below.

A widow or widower cannot be considered as head of household as long as he or she is entitled to the benefits of a surviving spouse (Note, however, that the latter's tax rate is more beneficial than the head of household rate).

### Requirement (2)—Maintenance of Household

The taxpayer must furnish over half of the cost of maintaining a household for the *entire year* for at least one relative (not his spouse). Whether this relative must also qualify as a dependent and whether he or she must actually live in the taxpayer's household depends upon the relationship.

*Father or Mother*—A father or mother must qualify as a dependent and must live with the taxpayer or in a home maintained for them. In this situation, qualification as a dependent cannot arise because of a multiple support agreement.

*Unmarried Child, Grandchild, Stepchild or Foster Child*—An unmarried child, grandchild, stepchild or foster child must live with the taxpayer, but does *not* have to qualify as a dependent.

*Any Other Relative*—Any other relative must live in the taxpayer's home and must qualify as a dependent.

*Temporary Absences*—Temporary absences for vacations, schools, sickness, etc., are disregarded in determining whether a related person actually lived in a household. Military service may be considered a temporary absence.

*The following items are included in the cost of maintaining a household:* rent, mortgage interest, taxes, insurance on the premises, repairs, utilities, domestic help, and food consumed in the home. The cost of clothing, education, medical and dental treatment, vacations, and transportation is *not* considered as part of the expense of maintaining a household.

*Example.* Taxpayer's wife died several years ago and he has not remarried. An unmarried son lives in the house, but he cannot be claimed as a dependent. The taxpayer furnished over half the cost of maintaining the home. Head of household status may be claimed by the taxpayer.

#### **Widow(er) With Dependent Child**

This computation results in the same tax liability as a joint computation and is available to an eligible survivor for only the two next succeeding taxable years following the death of the spouse.

The exemption deduction for the deceased spouse may not be claimed by the survivor when this filing status is used. (Remember that the exemption can be claimed for the year of death because the surviving spouse is permitted to file jointly with the decedent.)

The requirements for this computation are as follows.

- (a) One spouse must have died within the two preceding taxable years;
- (b) The husband and wife must have been entitled to file jointly for the year of death; it is immaterial whether they actually did file jointly;
- (c) The survivor must not have remarried;
- (d) The survivor must have a child or stepchild who qualifies as a dependent; and
- (e) The survivor must furnish over half the cost of maintaining a home which is the principal place of abode for a dependent child or stepchild, except for temporary absences (vacations, schools, sickness, etc.)

*Example.* Commander Palmer's wife died last year and a joint return was filed for that year. He was unmarried at the end of the current year and he maintained a residence for his child who qualified as his dependent. He may use the joint return tax computation for the current year since he qualifies as a surviving spouse. Note that he *cannot* claim an exemption deduction for his deceased spouse for the current year.

The privilege of filing as surviving spouse is not granted if:

- (a) The taxpayer remarries before the end of his taxable year; or
- (b) The taxpayer or his spouse was a nonresident alien.

## **What Form to File**

### **Eligibility for Filing Form 1040A**

Taxpayers may use Form 1040A for 1975 if:

- (1) their total income (regardless of amount) is from wages, salaries, tips, and not more than \$400 in dividends or interest, and
- (2) they do not itemize their deductions.

*Note.* Taxpayer may disregard the \$400 limitations for interest and dividends if not required to file a return but files to get the earned income credit.

### **Who May Not File Form 1040A**

A taxpayer is not eligible to file Form 1040A if the taxpayer:

- (1) had income other than wages, salaries, tips, or more than \$400 in either interest or dividends,

- (2) had uncollected employee tax (social security tax) on tips as shown on his Form W-2,

- (3) had received \$20 or more in tips in any one month and did not fully report these tips to his employer,

- (4) files a separate return and the spouse itemizes deductions,

- (5) is a nonresident alien (Form 1040NR should be used),

- (6) could be claimed as a dependent on his parent's return, and had \$750 or more of dividend and interest income, or has total income of more than \$10,000 if single or unmarried head of household (\$5,937 if married and filing separately),

- (7) claims the retirement income credit, or certain other credits, or

- (8) makes adjustments to gross income for sick pay, moving expenses, or employee business expenses.

See Instructions for Preparing Short Form 1040A for other circumstances in which a taxpayer may not use Form 1040A.

## **Here Is a Test To Help Taxpayers Decide Whether They Can Reduce Their Tax Liability by Itemizing Deductions on Form 1040**

A taxpayer filing jointly or as surviving widow(er) should itemize his deductions on Form 1040 if his income on line 12 of Form 1040A is:

- less than \$11,875 and his allowable itemized deductions (see Chapter 5) total more than \$1,900.
- between \$11,875 and \$16,250 and his allowable itemized deductions total more than 16% of line 12.
- over \$16,250 and his allowable itemized deductions total more than \$2,600.

*Note* if the taxpayer is married and filing separately the above dollar amounts must be divided in half.

A taxpayer filing as single or head of household should itemize his deductions on Form 1040 if his income on line 12 of Form 1040A is:

- less than \$10,000 and his itemized deductions total more than \$1,600.
- between \$10,000 and \$14,375 and his itemized deductions total more than 16% of line 12.
- over \$14,375 and his itemized deductions total more than \$2,300.

## **When and Where To File an Individual Income Tax Return**

15 April is the final date for filing individual income tax returns if taxpayers use a calendar year. The return should be sent to the appropriate Internal Revenue Service Center for the state in which the taxpayer is located as shown in the instructions on Forms 1040 and 1040A. If his principal place of abode for the tax year is outside the United States, and he has no legal residence or principal place of business in any Internal Revenue District within the United States, he should file his return with the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19155.

## Exceptions to 15 April Due Date for Calendar Year Individual Taxpayers

### Written Application

(1) A taxpayer may get an automatic two-month extension of time to file Form 1040 by properly completing Form 4868 (Application for Automatic Extension of Time to File U.S. Individual Income Tax Return). Taxpayers filing this application are assured of an extension of time to file unless notified to the contrary.

The application must be filed with the appropriate Internal Revenue Service Center on or before the normal due date of the tax return. In submitting Form 4868, it is necessary to make a tentative tax estimate for the year. Any tax due after taking into account prepayments (such as withholding or estimated tax payments) must be paid with the application.

Interest on any unpaid portion of the final tax is  $\frac{1}{2}\%$  a month (up to a maximum of 25%) from the original due date of Form 1040 to the date of payment. The late payment penalty of  $\frac{1}{2}\%$  a month will also apply unless there is reasonable cause for failure to pay on time. However, the late payment penalty will not apply if the balance due on the return is less than 10% of the total tax and payment of the balance due is remitted with the return.

Except in severe or undue hardship cases, a taxpayer must take advantage of the automatic extension provisions before any longer extension will be granted. Further extensions of time to file beyond 2 months will not be automatic and must be specifically granted. A taxpayer may request a further extension by filing Form 2688 (Application for Extension of Time to File U.S. Individual Income Tax Return).

(2) U.S. citizens abroad who expect to receive exempt earned income may request an extension by filing Form 2350.

*Note:* The duplicate Form 4868 should be attached to the face of the completed tax return when it is filed as evidence of the extension. Any payment you made with the application for extension should be entered on line 21(d), Form 1040. You may not use Form 1040A or elect to have the Internal Revenue Service compute your tax if you applied for an extension of time to file.

### Extension While Abroad

Citizens of the United States, who, on 15 April, are outside the United States and Puerto Rico, are allowed an automatic extension of time until 15 June for filing the return for the preceding calendar year. In addition to the tax liability due, however, interest on the liability is incurred at the rate of 9% per annum from 15 April, the normal due date, to the date paid. The interest rate is 6% on amounts due before July 1, 1975.

If a taxpayer takes advantage of this automatic extension, a statement must be attached to the return showing he was outside the United States or Puerto Rico on the due date.

The automatic 15 June extension applies to individuals filing separate returns when both spouses are outside

the United States or Puerto Rico on 15 April. It also applies when only one spouse is outside the United States or Puerto Rico on 15 April, provided a joint return is filed. What are the filing requirements of a husband and wife who wish to file *separate* returns if only one spouse is outside the United States or Puerto Rico on 15 April?

*Example:* Capt John Baker is stationed in Korea on 15 April 1976 and his wife is living in Idaho on that date. They decided to file separate returns for 1975. Capt. Baker has until 15 June 1976 to file his return but his wife must file her return by 15 April 1976. Had they filed a joint return the automatic 15 June 1976 extension would have applied in their case.

### Combat Zone Service or Hospitalization

Members of the Armed Forces of the United States, or any other individuals, such as Red Cross workers, Federal civilian employees, industrial technicians and accredited correspondents who support such Armed Forces have until 180 days after they leave a combat zone or are discharged from continuous hospitalization outside the 50 states and the District of Columbia as a result of injury incurred in the combat zone, for filing any Federal income, estate or gift tax return, or declaration of estimated tax, paying these taxes, claiming refund, bringing suit upon any of these claims, being liable for assessments or deficiencies, or being subject to levy.

### Missing Persons

No Federal income tax return of, or payment of any Federal income tax by, a member of a uniformed force or civilian officer or employee of any department who, at the time any such return or payment would otherwise become due, is absent from his duty station in a status of missing, missing in action, interned in a foreign country, captured, beleaguered, or besieged by a hostile force, or detained in a foreign country against his will, shall become due until the earlier of: (A) the 15th day of the 3rd month in which he ceased (except by reason of death or incompetency) to be absent unless within that period he again becomes absent under the foregoing conditions or (B) the 15th day of the 3rd month following the month in which an executor, administrator, or conservator of the estate of the taxpayer is appointed. The postponed returns should also be accompanied by explanatory statements when filed. Note that this postponement is not limited to the geographical limits of any combat zone.

The spouse of an individual in missing status may file a joint return during the period he is in missing status even if it is subsequently determined that he had been killed in action in a prior year. Such spouse may also file as surviving spouse (if she has a dependent child) for two years following the year in which her husband's missing status is changed.

### Statute of Limitations

The law prescribes a specific period within which the Commissioner may assess and collect income taxes. Listed below are various limitation periods applicable to

the assessment and collection of income taxes. The following is not all inclusive.

### General Rule

Normally income taxes will be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed), and no proceeding in court without assessment for the collection of the tax may be begun after the expiration of that period. An income tax return filed before the last day prescribed by law or by regulations for the filing thereof will be considered as filed on that last day. Whenever the period of limitations begins to run from the date of filing the return, it means the date of filing the original return. The limitations period does not generally begin on unsigned returns.

### Failure to File a Return

If a taxpayer fails to file a return there is no limitation on assessment and collection of income tax. The assessment may be made at any time.

### Files False or Fraudulent Return With Intent to Evade Taxes

If a taxpayer files a false or fraudulent return with intent to evade taxes there is no limitation on assessment and collection of income tax.

### Files and Omits More Than 25% of Gross Income Properly Includible Therein

If a taxpayer omits from his gross income an amount which is more than 25% of the gross income stated on his return, the period of limitations for assessment and collection of the tax expires 6 years from the date of filing the return.

### Statute of Limitations on Claims for Refund by Taxpayers

The period for filing timely claims for refund or credit on income tax is as follows:

(a) If a return is filed, a claim for credit or refund of an overpayment must be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever expires later.

(b) If no return is filed, the claim for credit or refund of an overpayment must be filed by the taxpayer within 2 years from the time the tax was paid.

The running of the statute of limitations on filing claims for refund is suspended because of service in a combat zone.

## Penalties

### Delinquency Penalty

In the case of failure to file an income tax return on or before the date prescribed for filing (determined with regard to any extension of time for such filing), there will be added to the tax required to be shown on the return, the amount specified below, unless the failure to

file the return within the prescribed time is shown to the satisfaction of the district director to be due to reasonable cause. The amount to be added to the tax is 5% thereof if the failure is for not more than one month, with an additional 5% for each additional month or fraction thereof during which the failure continues, but not to exceed 25% in the aggregate. The addition is computed on the net amount of tax due.

### Negligence Penalty

If any part of any underpayment of tax is due to negligence or intentional disregard of rules and regulations, but without intent to defraud, 5% of the underpayment will be added to the tax.

### Fraud Penalty

If any part of any underpayment of tax is due to fraud, 50% of the underpayment will be added to the tax.

Occasionally a taxpayer will, for one reason or another, fail to file an income tax return for a particular year. Failure to file can bring upon a taxpayer both a criminal and a civil fraud penalty, so that a taxpayer would be well counselled to file an income tax return no matter how late such filing is. Sometimes a taxpayer who owes tax does not have the funds to pay and, because he is unfamiliar with the law, fails to file a return, thus leaving himself open to the suspicion of fraud or penalties for failure to file. In the following years the taxpayer, once having failed to file, may not file even when refunds are due. Eventually when he does file he may lose his refunds for prior years because the statute of limitations has expired. Yet if he had filed a timely return for the first year that he owed some tax in which he could not pay, he would merely have been subject to 9% (6% before July 1, 1975) per annum interest (and the one-half of 1% penalty discussed below), and would not have left himself open to fraud penalties or jeopardized his refunds. Therefore, it is always better to file a timely return even if a taxpayer does not have the money to pay his tax liability.

### Failure To Pay Tax Penalty

If the taxpayer fails to pay the income tax when due there will be added to the tax an additional penalty charge of one-half of 1% a month, not exceeding a total of 25% of the overdue amount. For failing to pay the income tax when due, the penalty is imposed on the amount shown on the return as due, less amounts that have been withheld, estimated tax payments, partial payments, and other applicable credits. This penalty is not imposed if it is shown that the failure to pay the tax is due to reasonable cause and not to wilful neglect. The failure "to pay" penalties are in addition to the regular 9% interest charged on overdue taxes.

The 9% per year interest charged for delayed payment of tax is fully deductible from income in computing taxable income. The 1/2 of 1% penalty is not deductible in arriving at taxable income because it is specifically referred to as an addition to the tax and as a penalty.



## Estimated Income Tax Payment

### In General

In order to have all individual taxpayers on a pay-as-you-earn basis, many U.S. citizens, and resident and nonresident aliens are required to estimate their tax liabilities and to pay at least 80% of the tax in advance through so-called quarterly payments and withholding by the employer. Form 1040-ES, Declaration of Estimated Tax for Individuals, is used to report the estimated tax to the Internal Revenue Service and is filed with the taxpayer's income tax return. A nonresident alien must use Form 1040-ES (OIO).

**Additional charge for failure to pay estimated income and self-employment tax.**—An additional charge of 9% (6% before July 1, 1975) a year is imposed by law for underpayment of installments of estimated tax receipts in certain situations. The charge does not apply if each installment is paid on time and (a) is at least 80 per cent (66.2.3% for farmers and fisherman) of the amount due, or (b) is based on a tax computed by using your income for last year and this year's tax rates and exemptions. For additional exceptions in unusual cases see Form 2210.

### Who Must Make a Declaration

Every citizen or resident of the United States must make a declaration of his estimated tax if he:

- (1) can reasonably expect gross income to exceed
  - (a) \$20,000 in the case of
    1. a single individual,
    2. a head of household,
    3. a surviving spouse, or
    4. a married individual entitled to file a joint declaration if his spouse does not receive any wages; or
    5. a married person living apart (as described on page 4).
  - (b) \$10,000 in the case of a married individual entitled to file a joint declaration if both spouses receive wages;
  - (c) \$5,000 in the case of a married individual who is not eligible to file a joint declaration; OR
- (2) can reasonably expect to receive more than \$500 from sources other than wages subject to withholding.

No declaration is required, however, if the estimated tax can reasonably be expected to be less than \$100.

An employee having earnings subject to withholding may wish to have his employer withhold more than the minimum amount of income tax, thus reducing his estimated tax liability after deducting withholding and eliminating the need for a declaration. For the serviceman whose only source of income is his military pay, the possibility of an estimated tax penalty is remote because the withholding from such pay is more than adequate to cover his situation. However, many personnel have income not subject to withholding (dividends, interest, capital gains, annuities, rents, etc.). These people have the problem of filing an estimated tax declaration and making the quarterly payments in accordance with such declaration.

### Due Dates

Ordinarily calendar year taxpayers first file their declaration of estimated tax by 15 April of the taxable

year. For the taxpayer who is outside the United States on 15 April filing may be postponed until 15 June. If the estimated tax return is not filed until 15 June then one-half of the estimated tax is due and payable with the return. The following example illustrates the normal due dates and amounts of estimated tax payments:

Total estimated tax .....	\$3,000.00
Less. Estimated withholding from pay ...	\$2,000.00
Estimated tax .....	<u>\$1,000.00</u>
Payments of estimated tax—	
15 April (paid with declaration) .....	\$250.00
15 June .....	\$250.00
15 September .....	\$250.00
15 January (after end of taxable year) ..	\$250.00
Total .....	<u>\$1,000.00</u>

*Note:* The fourth payment (15 January after the end of the taxable year) need not be made if the taxpayer files his return on or before 31 January of the succeeding calendar year and pays in full the amount computed on his return as payable.

### Amended Declarations

Generally, if an individual has filed a declaration and the facts and circumstances later indicate that his income will be substantially greater or less than he previously estimated on his original declaration, the Amended Computation schedule on page 2 of Form 1040-ES should be used to determine the amended estimated tax. The amended estimated tax should then be shown in item 1 of the next declaration-voucher filed. A declaration or amended declaration which would otherwise be due to be filed on 15 January need not be filed if the income tax return for the taxable year is filed and the tax due paid by 31 January.

*Note:* It is important to retain copies of cancelled checks to prove payment of taxes to the Internal Revenue Service if the return is examined.

### Alternative

To circumvent the problem of filing a declaration of estimated tax (indeed to insure that no tax is due when the filing of a taxpayer's income tax return), an alternative method is presented.

(1) At the beginning of the taxable year estimate the taxable income for the coming year.

(2) Compute the tax.

(3) Divide the tax by the number of military pay checks in the year.

(4) Inform the personnel officer to withhold the amount computed in 3 above (to the nearest \$5 per pay check) from each pay check.

This suggestion requires little more work than that necessary to compute an accurate declaration of estimated tax.

### Additional Facts on Wage Withholding

An individual will not be subject to withholding of income tax if he certifies to his employer that he expects to have no income tax liability for the current year and that he had no tax liability for the prior taxable year.

This provision relieves individuals who earn less than the amount required to file a tax return from filing a return solely to obtain a refund of the tax *withheld*.

### Voluntary Withholding on Pensions and Annuities

Pension and annuity payments are subject to income tax withholding when the payee requests withholding.

If the taxpayer wants to take advantage of this provision he should contact his personnel officer.

### Summary

#### Who Must File—Citizens and Residents of the United States

Filing Status	Tax Year 1975
Single—under 65 .....	\$2,350
Single—65 or over .....	3,100
Married Filing Jointly .....	3,400
Married Filing Jointly (one spouse 65 or over) .....	4,150
Married Filing Jointly (both spouses 65 or over) .....	4,900
Married Filing Separately (See Note 1) .....	750
Married Couples Living Apart (See Note 2)	750
Dependent Taxpayer with Unearned Income (See Note 3) .....	750
Surviving Spouse .....	2,650

*Notes:* (1) The higher filing requirements do not apply if any other taxpayer is entitled to claim an exemption for either spouse.

(2) For married couples, the higher filing requirements apply only if they have the same household as their home at the close of the taxable year.

(3) Any unearned income of a taxpayer who could be claimed as a dependent of another reduces the filing requirement to \$750.

*Special Notes:* (1) Exemptions for blindness and dependents do not apply to the filing requirements.

(2) Taxpayers with \$400 or more of self-employment income must file.

#### General Information on Return

- (a) Social Security Number
- (b) Permanent Home Address (note refund situations requiring current mailing address)
- (c) Presidential Election Campaign Fund.

#### Filing Status

##### Separate Returns

##### General Rule

- (1) Filed by one taxpayer
- (2) Includes only his income and deductions
- (3) Filed in the name of and signed by that taxpayer
- (4) Normally filed by taxpayer who is not married at the end of his tax year.

##### Exceptions

- (1) Married taxpayers may file separate returns.
- (2) Citizen or resident who is married to one who was a nonresident alien at some time during the tax year must file a separate return unless he qualifies as head of household.

(3) Spouse died—survivor does not remarry before year end, a joint return may be filed.

(4) Single person may have head of household or surviving widow(er) status.

(5) Certain married individuals living apart.

#### Joint Returns

(1) Taxpayers may owe less if they file joint returns

(2) Marital status—If on last day of taxable year taxpayers are:

- (a) Married and living together
- (b) Living in common law if in common law state
- (c) Married and living apart but not divorced or legally separated
- (d) Separated under interlocutory decree of divorce.

(3) Effect of death of one spouse

- (a) Joint return for year of death.
- (b) Surviving spouse rate for two succeeding years if certain requirements are met.

(c) Remarriage in year of death—decedent's return must be separate. Newlyweds can file jointly.

(d) Executor must file on behalf of decedent or spouse when none is appointed.

(e) Refund claim with Form 1310—submit copy of death certificate.

(f) Both taxpayers must sign a joint return.

(4) Citizenship or Residence—ENTIRE TAXABLE YEAR.

#### Unmarried Head of Household Status

Rate is less than separate status, more than joint return status.

##### Requirements

(1) *Marital Status*

(a) Unmarried or legally separated on last day of tax year, or

(b) Married to a nonresident alien at some time during year and who meets second requirements, or

(c) Certain married individuals living apart.

(2) *Maintenance of household*

(a) Furnish over half of the cost of maintaining household

(b) For *entire* year

(c) For at least one *relative* (not his spouse).

*Relative*—Definition for purpose of (2) (c) above:

*Father or Mother*—must be dependent and must live with taxpayer or in a house maintained for them.

*Note:* Dependency qualification cannot arise from a multiple support agreement.

*Unmarried child, grandchild, stepchild or foster child*—must live with taxpayer—does not have to qualify as a dependent.

*Any other relative*—must live in taxpayer's home and be a dependent.

(d) *Temporary Absences*—Military service, vacation, school, sickness, etc., do not negate living with taxpayer clause.

(e) *Cost of Maintaining Household*—Rent, mortgage interest, taxes, insurance on premises, repairs, utilities, domestic help and food consumed in home are considered as costs of maintenance.

Clothing, education, medical treatment, vacations and

transportation are *not* considered as costs of maintenance.

### Surviving Spouse Status

- (1) Same tax rate as a joint return.
- (2) Available to an eligible survivor for only two next succeeding tax years following death of spouse.
- (3) Exemption for deceased spouse cannot be claimed by survivor.

#### Requirements

- (1) One spouse must have died within the two preceding tax years.
- (2) Must have been entitled to file jointly for year of death.
- (3) Survivor must not have remarried.
- (4) Survivor must have a child or stepchild who qualifies as a dependent.
- (5) Survivor must furnish 50% of the cost of maintaining a home which is principal abode of such dependent.

*Note.* Surviving spouse filing status cannot be used if taxpayer remarries before the end of his tax year or if the taxpayer or his spouse was a nonresident alien.

### When and Where to File

#### When to file

15 April filing date—normal calendar year taxpayer  
15 June if taxpayer is outside U.S.A. or Puerto Rico on 15 April

Interest at 9% per annum due from 15 April to filing date.

Extension by filing Form 4868 (Application for Automatic Extension) Combat zone service or hospitalization—180 days after leaving combat zone or hospital outside U.S.A.

Missing persons postponement—earlier of the 15th day of the third month in which he ceased to be absent or on the 15th day of the third month following the month in which an executor, administrator, or conservator of the taxpayer's estate is appointed.

#### Where to file

Military personnel—Appropriate Internal Revenue Service Center.

### Statute of Limitations

- (a) General rule—3 years after due date or filing date whichever is later
- (b) 25% understatement of income—6 years
- (c) Fraud—no statute

### Penalties

Failure to pay tax— $\frac{1}{2}$ % per month up to a maximum of 25%

Delinquency—5% per month up to a maximum of 25%

Negligence—5% of any underpayment

Fraud—50%

*Note:* Voluntary late filing may result in Delinquency

penalty—Maximum 25%. However, failure to file discovery by IRS can result in criminal and civil fraud.

### Declaration of Estimated Tax

*Penalty*—9% per annum broken down into quarterly installments

*Due Date*—15 April, (15 June if outside U.S. on 15 April)

*Installment Dates*—15 April, 15 June, 15 September, and 15 Jan. (note filing and payment by 31 Jan. negates 15 Jan. installment)

*Alternative*—Compute tax due and have pro-rata amount withheld each pay day.

### Quizzes for Chapter 1

#### Yes—No Quiz

Check applicable box to show if the taxpayer must file a tax return in each case study that follows. You may use the summary schedule to help you answer.

- A. Tax year 1975—Single taxpayer, age 20, a college student, \$2,000 earned wages, no unearned income.  
 Yes  No
- B. Tax year 1975—Single taxpayer, age 28, \$1,100 self-employment income, wage income \$550.  
 Yes  No
- C. Tax year 1975—Married couple, husband over 65, Social Security income of \$800, wage income of \$4,200.  
 Yes  No
- D. Tax year 1975—Married couple both under 65, wages \$5,900.  
 Yes  No
- E. Tax year 1975—Married couple both under 65, bank interest \$250, wages of \$2,500.  
 Yes  No
- F. Tax year 1975—Single, age 17, high school student, \$380 income from delivering newspapers, \$600 in wages, \$20 bank interest, dependent upon parents.  
 Yes  No
- G. Tax year 1975—Married couple, husband over 65, wife under 65, Social Security income \$965, wage income \$2,900, jointly owned dividend income \$550; interest income \$125.  
 Yes  No
- H. Tax year 1975—Married taxpayer filing separately, age 21, \$700 wages, \$97 in dividends.  
 Yes  No
- I. Tax year 1975—Single taxpayer age 67, dividend income \$950, wages \$1,400, interest income \$220, and tip income of \$250.  
 Yes  No

#### True—False Quiz

Indicate whether each of the following statements is true or false by inserting "X" in the appropriate box.

1. Every citizen of the United States must file a return if his gross income is \$750 or more.  
 True  False



2. If a single taxpayer's deduction exceeds his gross income of \$2,700 he is not required to file a return.
    - True  False
  3. A college student worked as a handy man during the summer vacation and earned \$2,200. He had no other income. His employer, however, was unable to pay the student's wages. In lieu of wages, the student accepted an automobile offered by the employer, which had a fair-market value of \$1,350 at that time. The student is required to file a return because he actually earned \$2,200.
    - True  False
  4. A husband and wife who are not living together but are not legally separated under a decree of divorce or separate maintenance on the last day of the taxable year may file a joint return.
    - True  False
  5. Sue, Jim's wife, died during the early part of the year. Sue had income from wages in the amount of \$300 for the taxable period from which \$36 in tax had been withheld. She had no other income. Jim remarried before the close of the year and his present spouse had no income. A return is not required to be filed for Sue.
    - True  False
  6. Assume the facts in question 5—Jim may file a joint return with Sue for the year to avail himself of her exemption, \$750, because it is in excess of her wages, \$300.
    - True  False
  7. A 17 year old student received \$900 in dividends and purchased a used car. Since he is under age 19 and receives more than one half of his support from his parents, he is not required to file a return.
    - True  False
  8. A husband and wife must be consistent in their choice of separate returns. If one spouse itemized deductions the other spouse must also itemize deductions.
    - True  False
  9. Citizens of the United States who are residing in a foreign country, or traveling in a foreign country on the due date of their returns are automatically entitled to an extension of time, for filing their returns, not to exceed 6 months.
    - True  False
  10. Bob filed a timely return for the calendar year 1972 on 1 April 1973. The statute of limitation would normally expire on 1 April 1976.
    - True  False
2. All of the following must file a return of income EXCEPT
    - A. a minor attending school who earned \$3,000 during vacations.
    - B. a single individual with tax liability of \$1,200 whose employer withheld taxes of \$1,250 on his salary.
    - C. a single individual with gross income of \$3,000 but who has deductions of \$3,500.
    - D. a single individual 71 years of age with gross income of \$2,600.
    - E. a United States citizen residing in France whose salary was \$20,000.
  3. H has gross income of \$4,000 and deduction of \$500. His wife, W, has gross income of \$500 from which \$50 has been withheld by her employer. They may file as follows:
    - A. A joint return not including W's income and deductions.
    - B. A joint return not including W's income and deduction with W also filing a separate return to receive a refund on taxes withheld by her employer.
    - C. A joint return including the income and deductions of both.
    - D. A joint return including the income and deductions of both with W also filing a separate return to receive a refund on the taxes withheld by her employer.
    - E. Any of the above.
  4. H became a widower in January and remarried in December of the same year. Neither his deceased wife nor his present wife had any gross income. In filing his return for the same year H
    - A. may file a joint return with his deceased wife.
    - B. may file a joint return with his present wife.
    - C. must file a separate return.
    - D. may file a joint return with his deceased wife for a one month period, a separate return for 10 months, and a joint return with his present wife for one month, each of the short periods subject to annualized computation.
    - E. may file as in D above not subject to annualized computation.
  5. A joint return would be advantageous in all of the following EXCEPT
    - A. when one spouse has a large amount of gross income and the other a nominal amount.
    - B. when both spouses have a modest income, but one spouse has a heavy medical expense and the other has none.
    - C. when one spouse has deductions in excess of gross income.
    - D. when one spouse has made contributions in excess of the allowable limitation and the other has not used up his maximum allowable deduction.
    - E. when gross income of one spouse is less than \$750.
  6. All but one of the following statements concerning the period of limitations with respect to assessment and collection of income tax are correct. Select the EXCEPTION.
    - A. There is no limitation period, if no return is filed.

### Multiple Choice Quiz

*Directions*—Circle the appropriate letter to select the best answer to each of the following questions.

1. The test to be applied in determining whether a return of income must be filed by a person residing in the United States is based on
  - A. gross income.
  - B. adjusted gross income.
  - C. a single individual with gross income of \$3,000.
  - D. net profits.
  - E. gross receipts.
2. All but one of the following statements concerning the period of limitations with respect to assessment and collection of income tax are correct. Select the EXCEPTION.
  - A. There is no limitation period, if no return is filed.

- B. If an individual omits from his gross income an amount greater than 25% of the gross income stated on his return, the period of limitation expires 6 years from date of filing.
  - C. If an individual files a false or fraudulent return with intent to evade taxes, there is no limitation period.
  - D. If an individual who files his return on a calendar year basis files his return on 30 January, the limitation period is 3 years after that date.
- \$595 for the taxable year and his net income was \$410.
- 2. Bobby Barr, the 19-year-old son of Captain Barr, who is stationed at Rome, Italy, was a full-time student at Columbia University. He visited his father in Rome and, while there, earned \$480 for part time work on which U.S. income tax was withheld.
    - a. Must Bobby file a United States income tax return?
    - b. May he obtain a refund of the U.S. income tax withheld from his earnings? If so, how?
  - 3. With what office should the following taxpayers file their United States income tax returns, if tax is due with the returns—
    - a. A taxpayer whose actual and legal residence is in St. Paul, Minn.
    - b. An officer of the United States Army on duty in Spain and having his legal residence in Georgia.
    - c. A civilian employee of the United States Air Force in Japan, who has no legal residence or principal place of business in the United States.
  - 4. Aunt Rebecca, the relative of Bill Edwards, a U.S. soldier, stationed in Heidelberg, Germany, spent the entire year in Edwards' home because of the illness of his wife. She had dividend income of more than \$750 from a stateside source.
    - a. Is she required to file a U.S. income tax return?
    - b. Assuming in the above situation that her only income was from Social Security benefits, would she be required to file a U.S. income tax return?

### Question—Answer Quiz

1. State whether a United States income tax return is required to be filed by a United States citizen under the following set of circumstances.
  - a. Chester Bradley accepted a discharge from the Air Force in Japan, on 15 January. He was unemployed for three months, then earned \$2,400 as a clerk in the Air Force Exchange. On 1 Oct. he reenlisted as a Staff Sergeant in the Air Force.
  - b. William Brown, a former Army sergeant over 65 years of age on 31 Dec. of the taxable year, earned \$1,900 from employment by the European Exchange Systems in its PX in Florence, Italy.
  - c. Oscar Mills, former Army machinist, 63 years of age, conducted his own lathing business at Vienna, Virginia. His gross income derived from capital as well as personal services was

# Chapter 2. Exemptions

## Introduction

This chapter deals with personal exemptions and dependency exemptions. Although it is true that, in military parlance, a wife is a dependent, it is most important to recognize that, for income tax purposes, a wife may be an exemption but *never* a dependent. You will notice that five dependency tests must be met before exemptions for dependents may be claimed. There are, however, special relief provisions applicable to claiming dependent children which do not apply to other relatives.

## Objectives

Participants should be able to explain the following concepts:

(1) All situations involving personal and dependency exemptions

(2) The correct procedure for preparing Form 1040 and Form 1040A

Applicable forms for this chapter include.

*Form No.*

2120 Multiple Support Declaration.

## Personal Exemption

Every taxpayer is entitled to a personal exemption of \$750 in filing a Federal Income Tax Return. In addition, the taxpayer may be entitled to extra exemptions for age, blindness, spouse, and dependents.

## Credit

In addition to the \$750 personal exemption, a \$30 tax credit is allowed for each personal exemption that a taxpayer can claim. However, there are no credits for the additional exemptions for taxpayers who are 65 or over or blind. The credit is available only for taxable years ending in 1975.

## Exemption for Age

An additional \$750 exemption is allowed a taxpayer who is 65 or older by the last day of the tax year. A person is considered to be 65 on the day before his 65th birthday.

## Exemption for Blindness

An additional \$750 exemption is allowed a taxpayer if he is blind on the last day of the tax year. A person is considered to be blind if the central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or the widest diameter of the visual field subtends an angle no greater than 20 degrees. If a taxpayer is totally blind, a statement to this effect must be attached to the return. If the taxpayer is partially blind, a statement from a qualified physician or registered optometrist must be attached to the return verifying that the taxpayer's vision is not greater than described above. If partial blindness will never improve

beyond the above standards, the taxpayer should attach to the return a certified opinion to this effect from a physician skilled in diseases of the eye. In future years, only a statement referring to this opinion need be attached.

## Exemption for Wife or Husband

A married taxpayer filing a joint return may claim an exemption for his or her spouse. The exemptions for age and blindness also apply for both spouses, but they are not allowed for a dependent. (Note that when filing jointly all taxable income of both spouses must be included on the return).

*Example.* Assume husband and wife file a joint return and have no children or other dependents.

(1) If both were under 65 and neither was blind, they would be entitled to two exemptions.

(2) If both were under 65 and one was blind, they would be entitled to three exemptions.

(3) If both were over 65 and blind they would be entitled to six exemptions.

If a separate return is filed by a married taxpayer, an exemption for the spouse may be claimed only if such spouse has no income and is not the dependent of another taxpayer. If both husband and wife file separate returns, neither may claim an exemption for the other.

*Example.* Husband and wife each filed separate returns. The wife earned \$300 from which \$40 income tax was withheld. She received a refund of \$40 on her return. The husband cannot claim her as an exemption on his return even though her income was less than \$750.

There is an important distinction between an exemption and a dependent. The rules for claiming dependency exemptions do not apply to personal exemption of spouses. For instance, even though the taxpayer did not marry until December 31 (his wife being supported by her father until then) he still is entitled to file a joint return and claim her as an exemption. As we shall see in the next section, the wife's father could not claim her as a dependent under these circumstances.

If the taxpayer's wife died during the year, he may still claim her exemptions if he has not remarried by the end of the year. If a taxpayer is divorced or legally separated from his wife at the end of his tax year, he may neither claim an exemption for her nor file a joint return with her.

## Exemption for Nonresident Alien Spouse

A United States citizen may claim an exemption for a nonresident alien spouse if the alien spouse has no income from United States sources and is not the dependent of another taxpayer. The exemptions for age (being 65 or more) and blindness are allowed in the case of the nonresident alien spouse exemption.

## Exemptions for Dependents

The taxpayer is allowed an exemption of \$750 for each person who qualifies as a dependent of the taxpayer.

However, no additional exemptions are allowed for the age or blindness of a dependent. If the dependent was born or died during the year, a full \$750 exemption is allowed if the dependency tests are met for the part of the year in which the dependent lived.

To obtain this \$750 dependency exemption each of the following five separate tests must be met.

- (1) Support Test
- (2) Gross Income Test
- (3) Member of Household or Relationship Test
- (4) Citizenship Test
- (5) Joint Return Test

See Appendix C for step-by-step procedures for applying these tests.

## Support Test

The taxpayer must furnish over half of the total support of the dependent during the calendar year. In determining whether an individual has received over half of the support from the taxpayer, compare the amount of the support provided by the taxpayer with the entire amount of support which the individual received from other sources. This includes tax-exempt income and savings which are used for the support of the dependent. Items not to be considered when determining total support are scholarships, automobile purchases, life insurance premiums, and Federal, state and local income tax payments.

Total support is generally the total expenditures incurred in furnishing food, shelter (at its fair rental value), clothing, education, medical and dental care, recreation, transportation, and other similar necessities.

## Miscellaneous Support Information

(1) Amounts paid to others as child care or disabled dependent care to enable the taxpayer to be gainfully employed may be included as part of total support, even though such amounts are deductible as itemized deductions.

(2) Social Security benefit payments made to a child of a disabled parent must be considered as furnished by the child in determining who furnished more than one-half of the child's support.

(3) Amounts received as a scholarship for study at an educational institution by the taxpayer's child, step-child or legally adopted child who is a student are not taken into account in determining total support.

*Example:* Taxpayer's son receives a scholarship valued at \$1,000. In the same year the taxpayer provides the son's only other support of \$800. The taxpayer may claim the son as a dependent as the \$1,000 is not counted in determining total support.

(4) An appointment to any Armed Services academy is not a scholarship. In fact, a relative in an Armed Service academy may not be claimed as a dependent if this person is there for a full year. Nor may a relative in the Armed Services be claimed as a dependent. Such person is supported by the Armed Services or self supported, whether an officer, enlisted man, cadet, or midshipman. If such relative is in the Armed Services or one of the academies for only part of the year, such person may be claimed as an exemption if all the five dependency tests are met. However, the amount of com-

pensation and allowances received by the relative from the Armed Forces and used for this relative's support must be taken into account. This is true of cadets and midshipmen also, since such appointments do not constitute scholarship awards.

(5) Tax-exempt income (social security, armed forces family allotments, nontaxable pensions, etc.) and savings which are used for the support of a dependent must be included in computing total support to determine whether the taxpayer furnished more than half of such total support.

(6) The part of a dependency allotment contributed by the Government, as well as the part withheld from the pay of service personnel, is considered furnished by that person in determining whether this person furnishes over half the support of a dependent. If the allotment is used to support dependents other than those from whom the allotment is authorized, an exemption may be claimed for those other dependents if they otherwise qualify.

*Example:* Taxpayer is in the Armed Forces and authorized a dependency allotment for his widowed mother, who used the amount received for the support of herself and his younger sister. He provides no other funds for their support. If more than half of their support is provided by the allotment, the taxpayer may claim exemptions for both his mother and his sister, even though the allotment was authorized for only his mother.

*Caution:* A taxpayer should keep careful records of the amounts spent for the support of dependents, particularly if the taxpayer is divorced or legally separated because the amount of support furnished to any of the taxpayer's children not living with the taxpayer during the year as well as the amount of support furnished other dependents must be entered on the tax return.

## Multiple Support Agreement

In one exceptional situation the taxpayer may claim a dependency exemption even though the taxpayer did not provide over half of the dependent's support. When two or more persons together support another individual for the calendar year, one of the contributing group may take the deduction if:

(1) No one person contributed more than half the dependent's support, and

(2) Each member of the group, were it not for the support test, would have been entitled to the dependency exemption, and

(3) The member of the group claiming the deduction gave more than 10% of the dependent's support, and

(4) Each member of the group, except the person claiming the exemption, files a Form 2120 indicating that they will not claim the same exemption in the same calendar year. The Form 2120 must be attached to the return of the individual claiming the dependent.

## Support Test in Case of Child of Divorced Parents

Generally, if—

(1) A child receives over half of his support during the year from the child's parents who are divorced or legally separated and



(2) Such child is in the custody of one or both parents for more than half of that year.

**Then—**

Such child shall be treated as receiving over half of his support from the parent having custody for the greater portion of the year

**Unless—**

(1) The decree of divorce or separate maintenance provides that the parent not having custody shall be entitled to the deduction for the child and such parent provides at least \$600 for support

**OR**

(2) The parent not having custody provides \$1,200 or more (or if there is more than one such child, \$1,200 or more for all of such children), and the parent having custody does not clearly establish that he (or she) provides more for the support of such child.

If the divorced parent having custody is remarried and his or her new spouse provides support for the child, and the parent and the new spouse file a joint return, then the support contributed by the new spouse will be considered to have been contributed by the divorced parent and be added to his or her support for purposes of this test.

Chart 3 in Appendix C provides a step-by-step procedure in applying the support test for a child of divorced parents.

**Gross Income Test**

The dependent's gross income for the calendar year must be less than \$750 unless the dependent is the taxpayer's child and (a) is a student, or (b) has not reached age 19 by the close of the calendar year.

A "student" is defined as one, who during some part of any five calendar months of the taxable year, is in full-time attendance at an educational institution.

For tax purposes, the term child includes the taxpayer's son, daughter, stepchild, legally adopted child, a child placed by an authorized agency in the taxpayer's home for legal adoption, or a foster child.

*Example.* Taxpayer's 23-year-old son earned \$750 during the calendar year while he was a full-time student. His 18-year-old daughter earned \$800 during the year. The taxpayer provided over half the support for both children. The taxpayer is entitled to a dependency exemption of \$750 for each child, even though the children will file their own returns and also claim their own exemptions.

In making the gross income test, the gross receipts from rental property is considered as gross income without reduction for taxes, repairs, etc.

**Member of Household or Relationship Test**

To be claimed as a dependent a person must either be (1) a member of the taxpayer's household and live with the taxpayer for the entire year, or (2) related to the taxpayer.

An individual is not a member of the household if at

any time during the tax year the relationship between the taxpayer and the individual violates local law.

A relative for this purpose includes a taxpayer's children, grandchildren, great grandchildren, stepchildren, brother, sister, parents, grandparents, stepmother or father, a brother or sister of the taxpayer's father or mother, nieces, nephews and his in-laws. Once any of these relationships are established by marriage they are not terminated by death or divorce.

*Dependency deduction for foster children—*A foster child is considered to be your child if your home is the child's principal place of abode and the child is a member of your household for the entire year. Thus, for example, you may claim a dependency exemption for your foster child even though he has \$750 or more gross income for 1975 (if the child is under 19 years old or is a student), provided he is a member of your household and you furnish more than half of his support for the year.

**Citizenship Test**

An individual who is not a United States citizen or national will not qualify as a dependent unless (1) a resident of either the United States, Canada, Mexico, Canal Zone, or the Republic of Panama at some time during the calendar year in which the taxable year of the taxpayer begins, or (2) legally adopted by a citizen taxpayer and for the taxable year of the taxpayer has the principal place of abode in and as a member of the citizen taxpayer's household.

A child born to or legally adopted by a taxpayer in the Philippine Islands before 1 January 1956 may be claimed as a dependent if the taxpayer was a member of the Armed Forces of the United States at the time the child was born or adopted and the child is a resident of the Republic of the Philippines during the taxable year.

A child born in a foreign country, whose mother is a nonresident alien and whose father is a U.S. citizen, is a U.S. citizen and qualifies as a dependent provided the other dependency tests are met.

**Joint Return Test**

A taxpayer is not allowed an exemption for the dependent if he or she files a joint return.

*Example:* Taxpayer supported his daughter for the entire year while her husband was in college and working. She and her husband filed a joint return. Even though taxpayer meets all the other tests, the daughter may not be claimed as a dependent because she filed a joint return.

*Note:* There is one exception to this rule. A dependency exemption, otherwise allowable, will not be disallowed if a joint return is filed by the dependent and his or her spouse merely as a claim for a refund and if no tax liability exists for either spouse on the basis of separate returns.

**Summary**

**Personal Exemptions—\$750**

**Separate Returns Filed by Husband**

Husband can claim wife only if she has no U.S. income and is not the dependent of another (military

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man's wife who is supported by her father cannot be claimed by the military man if he files a separate return).

## Distinction Between Exemption and Dependent (Wife v. Relative)

### Exemptions for Dependents—\$750

(is not prorated)

*Note.* No additional exemptions are allowable for dependents who are 65 or blind.

Death of dependent during the year has no effect on the exemption.

### Dependency Tests

Five dependency tests: Support, gross income, member of household or relationship, citizenship, joint return.

#### Support Test—

- (1) Furnish over 50% support during calendar year
- (2) Scholarships are not considered in determining total support
- (3) Items considered as support:

Food	Medical care
Shelter	Recreation
Clothing	Child care
Transportation	Education
Child support (but not alimony)	

*Note:* Armed Forces academy appointees who are there for the entire year are not dependents. However, if appointees for only part of year they may be dependents if other tests are met.

Relatives in the Armed Forces are not dependents of anyone.

Total dependency allotments and B.A.Q. allotments are considered as support provided by military personnel (both his pay and that paid by the Government). If such allotment is used to support another relative the military man may also claim dependency for such other relative—all other tests being met.

*Multiple Support Declaration—See Form 2120.*

#### Gross Income Test

Must be less than \$750 unless

- (1) Child is under 19 at the end of year, or
- (2) Full-time student.

#### Member of Household or Relationship Test

- (1) Must be member for entire year (including foster children), or
- (2) must be related (children, grandchildren, great grandchildren, parents, grandparents, stepchild, brother, sister, stepmother or father, brother or sister of father or mother, nieces, nephews and in-laws).

#### Citizenship Test

- (1) Must be citizen or national of the U.S., or
- (2) resident of U.S., Canada, Mexico, Canal Zone, or Panama at some time during the year, or

(3) legally adopted by a citizen and is a member of the household of such citizen for the entire year and the principal place of abode is such citizen's household.

#### Joint Return Test

Taxpayer cannot claim dependent if such dependent files a joint return.

## Quizzes for Chapter 2

### Question—Answer Quiz

1. What are the income tax exemptions granted to an individual United States citizen taxpayer under 65 and not blind.
  - a. who files a separate return?
  - b. who files a joint return with his spouse?
2. What proof of blindness is required?
3. Give the five general tests which must be satisfied to entitle the taxpayer to an exemption for a dependent.
4. a. Is the exemption for a dependent ever allowed for an individual who has \$750 or more gross income?  
b. If so, give the circumstances.
5. Is the requirement for citizenship or residence of a dependent ever waived? If so, please explain in detail.
6. What expenditures are included in the term "support"?
7. Is the amount of a Class "Q" allotment properly considered to be a support payment by the member of the Armed Forces who makes the allotment?
8. Is a spouse ever considered to be a dependent? Why?
9. The wife of Colonel Briggs is a Greek citizen. Her sister lived in the Briggs' home in Athens, Greece, for the entire taxable year and Colonel Briggs supplied more than 50% of her total support.
  - a. May Colonel Briggs claim his sister-in-law as a dependent?
  - b. What would be your answer to (a) if the sister-in-law were a Canadian?
10. Jane Farley lived in her father's home in Indianapolis, Indiana, for the entire taxable year. Her father supplied more than 50% of her total support, however, her husband, an army private on duty abroad, filed a joint return with his wife.
  - a. May Jane's father claim her as a dependent on his return?
  - b. Had Jane's husband filed a separate return, would he have been entitled to claim her as an exemption if her father, who supplied more than 50% of her support, also had claimed her on his return?
11. The 19-year-old son and the 17-year-old daughter of Major Albeer were full time students who lived

at home and attended the Munich branch of Maryland University. During vacation, the son earned \$800, \$500 of which he invested in common stocks which he planned to hold for long-term growth. The daughter earned \$100 which she used to buy clothes for her own use. Major Albeer paid more than 50% of the total support of the children. Is Major Albeer entitled to dependency exemptions for both of his children? If not, explain.

12. Colonel Howard, a native of Miami, Florida, owns and maintains a small house there which is used as the home of Mrs. Howard's parents. The parents have no other income except Social Security benefits, but do receive some amounts from another son, Andrew, and a daughter, Bettsy. Andrew and Bettsy signed written agreements that they would not claim their parents as dependents. The Social Security benefits amounted to less than 1/2 of Mrs. Howard's parents' total support.
  - a. Is Colonel Howard entitled to claim Mrs. Howard's parents as dependents on his joint U.S. income tax return?
  - b. Suppose the home had a fair rental value of \$200 per month, and that Andrew and Bettsy contributed \$2,000 each to the support of their parents, who would be entitled to claim the parents as dependents?
13. The wife of Captain Thompson is a native of Izmir, Turkey, and she has never visited the United States.
  - a. Is Captain Thompson entitled to an exemption for his wife on his U.S. income tax return?
  - b. Assuming Mrs. Thompson earned \$2,000 as a secretary for a United Nations Mission to Turkey, would your answer to question "a" remain the same?
  - c. May Captain and Mrs. Thompson file a joint return under either "a" or "b"?
14. Warrant Officer Jones is unmarried and has lived abroad for many years. His mother, a widow, lives with another widow, a life-long friend, who owns and maintains the house in which they live. W/O Jones contributed \$1,200 to his mother's support. His married sister contributed \$500 in cash and clothing valued at \$150 to their mother's support. If the fair rental value of the quarters supplied by the friend was \$1,200 (a) who may claim an exemption for the mother? and (b) is a multiple support agreement necessary? (c) If so, by whom should it be signed?

### Support Test Problem

#### Facts

Bill and Nancy Coslow were separated under a written separation agreement in 1965. The written separation agreement provided that Bill would pay \$300 per month for the support of Nancy and \$75 per month for the support of their child. As provided in the agreement, Nancy had custody of the child for the entire year 1975.

#### Assumption No. 1 (based on the above separation agreement)

During 1975 Bill paid the \$3,600 for the support of Nancy and \$900 for the support of the child. Nancy spent \$1,700 for the total support of the child. Bill and Nancy did not file a joint return for 1975.

Who is entitled to the child's exemption for 1975?—

#### Assumption No. 2

Assume the same facts as in Assumption No. 1, except that on January 1, 1975, Bill and Nancy entered into a written agreement which stated that Bill would be entitled to the child's exemption on his tax return.

Who is entitled to the child's exemption for 1975?—

#### Assumption No. 3

During 1975 Bill paid the \$3,600 for the support of Nancy and \$900 for the support of the child. In addition, he had custody of the child for seven months during the year. During this seven month period he provided \$1,000 toward the child's support. The total support (provided by both parents) of the child was \$4,000 for the year.

Who is entitled to the child's exemption for 1975?—

### Return Preparation Problem

Prepare Form 1040A, using information below. (Compute balance of tax due or overpayment)  
Joseph P. Brown, E7, U.S. Army, unmarried

Permanent Home Address:

2000 Main Street  
Rockville, Maryland 20850  
Montgomery County

Social Security Number: 452-22-6389  
Filed previous year's return from same address

Salary: U.S. Army .....	\$6,163
(Tax Withheld \$816.00)	
Dividends, X Corp. ....	62
Interest, National Bank (savings acct.) .....	315



## Tax Computation Problems

Complete the tax for the taxpayers in the filing situations below (not able to itemize)  
Use Optional Tax Tables which show the tax before the \$30 credit for 1975.

Adjusted Gross Income	Filing Status	Income Tax
(a) \$ 9,200.00	Married, filing jointly Two children	
(b) 6,803.00	Single	
(c) 7,322.00	Married, filing jointly	
(d) 8,733.00	Husband 66; wife 60 and blind Husband filing separately Spouse not filing—no income Two dependent children One child, blind	
(e) 6,378.00	Taxpayer, age 65 One dependent child Head of household	
(f) 11,112.00	Married, filing jointly Three dependent children	
(g) 12,126.00	Married, filing separately, two dependent children, spouse also filing	
(h) 13,202.00	Single	

# Chapter 3. Gross Income

## Introduction

You learned in Chapter I that the liability of a taxpayer for filing a return is determined by the amount of his "gross income." Determination of "gross income" is the first step in the computation of an income tax liability. This chapter deals first with those items of income which are specifically taxable to the Armed Servicemen (various types of military pay) and then to other types of taxable income which apply to all taxpayers (dividends, interest, etc.). When reference is made to a particular part of Form 1040 or Form 1040A, look at the Form. In this way you will become familiar with the returns.

## Objectives

Participants should be able to explain the following concepts:

- (1) The different types of income to be reported, e.g., military pay and other income; and where such items are reflected on Form 1040 or Form 1040A.
- (2) The law and practical application of Form 1040.
  - (a) Supplemental income, Schedule E
  - (b) Capital gains and losses, Schedule D

Applicable forms for this chapter include.

### Form No.

Schedules A & B, Itemized Deductions and Dividend and Interest Income  
Schedules E & R, Supplemental Income Schedule and Retirement Income Credit Computation  
Schedule D, Capital Gains and Losses  
2350 Application for Extension of Time for Filing U.S. Income Tax Return  
(U.S. Citizen Abroad Expecting Exempt Income)  
2119 Sale or Exchange of Personal Residence  
4798 Capital Loss Carryover

## Income Defined

"Income" has been defined as the gain derived from capital, from labor, or from both combined provided it is understood to include profit gained through a sale or conversion of capital assets.

Since income is not present unless there is a gain, you can see that a mere return of capital is not included in gross income. For example, the total of money and other property received from a sale of property is not includible in gross income except to the extent that the total amount received exceeds the adjusted basis of the property. In other words, only the gain on the sale is a part of gross income.

## Form of Income

Gross income includes income realized in any form, whether in money, property, or services. Income may be realized in the form of services, meals, accommodations, notes, stock or other property, or the right to receive property, as well as cash. Income received in forms other than cash must be included at fair market value. However, income must be "realized" before it can

be taxed. For example, gross income does not include (1) the unrealized increase in value of property owned by the taxpayer, (2) the rental value of one's own home, (3) the value of the wife's services in the home or (4) the value of livestock and products raised on the farm and consumed by a farmer and his family.

## Military Taxable Wages Subject to Withholding and Reported on Form W-2

### Basic Pay

Monthly basic pay is prescribed for each pay grade according to cumulative years of creditable service of the member.

### Incentive Pay

- (1) *Aviation*—Pay for the performance of duty involving frequent and regular participation in aerial flights.
- (2) *Parachute*—Pay to members holding a parachute rating when required to engage in parachute jumping from an aircraft in aerial flight.
- (3) *Demolition*—Pay for demolition duty when member performs such duty as a primary assignment.
- (4) *Leprosy*—Pay for duty involving intimate contact with persons afflicted with leprosy.
- (5) *Human acceleration or deceleration*—Duty as a human acceleration or deceleration experimental subject.
- (6) *Experimental Pressure Chamber Duty*—Duty within a pressure chamber during stress experiments (either as human test subjects or research technicians).
- (7) *Thermal stress*—Duty as a human test subject in thermal stress experiments.

### Special Pay

- (1) *Foreign Duty Pay*—Applicable to enlisted members only. Pay for duty at designated places outside the fifty states and the District of Columbia.
- (2) *Sea Duty*—Pay for duty performed on a vessel pursuant to orders of competent authority, other than when the vessel is restricted to service in the inland waters of the United States.
- (3) *Diving*—Pay for duty while engaged in diving operations.
- (4) *Medical and Dental*—Pay to certain medical and dental officers entering on active duty.
- (5) *Veterinary*—Pay to certain Veterinary Corps officers.
- (6) *Proficiency Pay*—Pay to enlisted members who have been designated as possessing special proficiency in a military skill.

### Lump-Sum Payment for Accrued Leave

A member of the Armed Forces separated under honorable conditions, who is not required to carry leave forward, will be compensated for a maximum of 60 days accrued leave standing to his credit at time of separation, based on the following pay and allowances.

(1) *Officers*—Basic pay and basic allowances for quarters and subsistence applicable on date of separation.

(2) *Enlisted members*—Basic pay applicable to such members on date of separation plus a subsistence allowance at the rate of \$0.70 per day for all enlisted grades and a quarters allowance at the rate of \$1.25 per day for enlisted persons in pay grade E-5, having dependents at the time of separation. The maximum being \$6.48 received by enlisted persons in pay grade E-9.

*Note:* Only the amount of accrued leave payment that represents basic pay is considered taxable wages subject to withholding and reporting in Form W-2.

### Reenlistment Bonus

A member who reenlists in the Regular Army within 3 months after the date of his discharge or release from active duty is entitled to a bonus computed on the basis of the number of the reenlistment (first, second, third, fourth, etc.) and the monthly basic pay to which the member was entitled or a specific amount for each enlistment period.

### Severance Pay

Each Regular Army officer removed from the active list and honorably discharged will usually be paid severance pay if on the date of removal he is not eligible for voluntary retirement under any provision of the law. Severance pay is computed by multiplying 1 or 2 month's basic pay at rate applicable on date of removal by the number of years of active Federal commissioned service (but not over 12). Maximum payable is 1 or 2 year's basic pay or \$15,000 whichever is less.

### Readjustment Pay

A Reserve member who is involuntarily separated from the active service and who has completed, immediately prior to such separation at least 5 years of continuous active duty, is entitled to a lump-sum readjustment payment. Member will receive 2 months' basic pay in the grade in which serving at the time of separation, multiplied by the number of years of active Federal service (but not over 18), not to exceed 2 years' basic pay or \$15,000 whichever is less. There are two exceptions. Readjustment pay equals one-half of 1 month's pay multiplied by the years of active service, if the member is separated—

- (1) Because his performance of duty falls below standards prescribed by the Secretary of the Army, or
- (2) Because his retention is not clearly consistent with the interests of national security.

### Dislocation Allowance

The dislocation allowance (DLA) partially reimburses a member with dependents for the expense incurred in relocating his household upon a permanent change of station. The amount of this allowance is equal to the applicable monthly rate of basic allowance for quarters of the member.

Therefore, DLA is added to other active duty pay and is normally taxable.

The above mentioned items appear on Form 1040, line 9, or Form 1040A, line 9 if this form can be used.

#### Notes:

(1) If the taxpayer has W-2s from more than one employer or if, in filing a joint return, both taxpayers have a W-2 form the wages are added together and the total entered on Form 1040, line 9 or Form 1040A, line 9.

(2) Attach a copy of all W-2 forms to the return.

## Forms 1040 and 1040A for 1975

Either Form 1040 or Form 1040A is used to report income from wages, salaries, and tips regardless of the amount. These forms, however, may not be used by nonresident aliens.

### Form 1040A

The gross income of most military personnel fits within the framework of Form 1040A. However, see Chapter 1 for certain restrictions as to the use of Form 1040A.

### Form 1040 with Schedules

Any taxpayer, other than a nonresident alien, may file this form regardless of the source of income. If a taxpayer has income from sources other than salaries or wages, schedules are provided as follows:

Schedule B, for dividends over \$400 or interest over \$400;

Schedule C, for business or self-employment income;

Schedule D, for gains or losses on sales or exchanges of property;

Schedules E and R, for income from pensions, etc., rents, partnerships, estates, small business corporations, retirement income credit;

Schedule F, for farm income and expenses.

## Form 1040X Amended U.S. Individual Income Tax Return

Form 1040X may be used to correct an individual income tax return for any year filed. While the use of the form is not mandatory, the Internal Revenue Service prefers that it be used rather than an amended Form 1040, Form 1040A or Form 843 since the Form is designed to expedite processing.

Form 1040X can be filed only after filing an original return. Form 1040X must be filed within 3 years from the date the original return was filed (a return filed early is considered to have been filed on the due date) or within 2 years from the time the tax was paid, whichever is later.

## Income From All Sources Other Than Wages

Form 1040, lines 10, 11, and 12 are used to report all other income other than wages, salaries, tips, etc. Reference is made to Schedules B, C, D, E, and F (Form 1040) which represent the total of all other income.

The breakdown consists of the following items.

- Dividends and Interest, Schedule B
- Business Income, Schedule C
- Capital Gains and Losses, Schedule D
- Supplemental Income, Schedule E
- Farm Income and Expenses, Schedule F

As you can see you are again referred to other parts of Form 1040 (e.g., Schedules C, D, E, F, etc.). From the practical standpoint of preparing a Form 1040 which has "other income" it is imperative, therefore, to complete all the appropriate Form 1040 schedules and their attachments. When completed, their net results can easily and correctly be entered on the Form 1040.

## Dividends—Schedule B

Dividends are distributions of cash or property by a corporation to its stockholders. Most distributions are made out of the earnings of a company and are taxable as dividends. Taxable dividends are the most common type of dividends and can be assumed to be taxable unless the paying corporation indicates otherwise.

## Nontaxable Distributions (Dividends)

(1) *No Earnings and Profits*—Sometimes a company will make distributions not out of earnings and profits which are not taxable since they are, rather, a return to the stockholders of a part or all of their investment in the corporation. However, this situation is rare. The taxpayers, in such situations, are well advised by the companies.

(2) *Stock Dividends*—Stock dividends are usually nontaxable because, while a stockholder now owns more shares in a corporation, his percentage of ownership remains the same. For example if XYZ Corporation is owned by two shareholders, A and B, both of whom have 100 shares of stock in the corporation and XYZ Corporation distributes as a dividend a further 5 shares to each person. A and B now own 105 shares each, but their percentage of ownership (50%) has not changed nor has XYZ Corporation enlarged itself in any material way. (The pie is the same size but cut into more pieces.) There are several exceptions to a stock dividend being tax free:

(a) When you have the election to receive cash or other property in place of stock or stock rights;

(b) When the distribution results in the receipt of cash or other property by some shareholders and an increase in the proportionate interests of other shareholders in the corporation's assets or earnings and profits;

(c) When the distribution is in convertible preferred stock and it has the same result as in (2), above;

(d) When the distribution results in the receipt of preferred stock by some common shareholders and common stock by other common shareholders, and

(e) When the distribution is with respect to preferred stock (other than an increase in the conversion ratio of convertible preferred stock made solely to take into account a stock dividend or stock split with respect to the stock into which such convertible preferred stock is convertible).

In addition, any transaction having the effect of increasing a shareholder's proportionate interest in the corporation's assets or earnings and profits may be taxable even though no stock or stock rights are actually distributed.

*Basis.* In a nontaxable distribution, the basis of your old stock is allocated between the old and the new stock.

## Dividends on Stock Sold

When stock is sold, dividends declared and paid after the sale are income to the purchaser. When the stock is sold after the declaration, but before payment of the dividend, the dividend received by the seller is income to him, because he was the owner of record. The fact that the purchase price may have been increased in contemplation of the next dividend does not exempt the dividend from tax. The increase in purchase price is merely part of the purchaser's price of the stock.

## Dividends on Insurance Policies

Dividends paid by mutual insurance companies to policyholders are not true dividends but are in effect a partial return of the premiums previously paid. They reduce the cost of the insurance contract and are not includible in gross income until they exceed the accumulated net premiums paid for the contract. However, the interest on such dividends is taxable as interest.

## Dividends From Mutual Funds

If a taxpayer owns stock in a mutual fund, the dividends he receives which are true dividends (subject to the dividend exclusion) are the amounts so designated by the company in a written notice mailed to the taxpayer. The amount which is designated in the notice as a capital gains dividend should be so reported by the taxpayer on line 7, Part II, Schedule D of Form 1040.

## Dividends From Savings and Loan Associations

For income tax purposes dividends on deposits and withdrawable accounts from Savings and Loan associations are not treated as dividend income but rather as interest income.

## Dividend Exclusion

Gross income does not include amounts received by an individual as dividends from *domestic* taxable corporations (called qualifying dividends) to the extent that the dividends do not exceed \$100. Dividends received from nonqualifying corporations (foreign corporations and nontaxable domestic corporations) are nonqualifying dividends.

On a joint return each spouse can exclude, to the extent received, \$100 in qualifying dividends. If the spouses jointly own stock then the dividend income should, for exclusion purposes, be split between them. If one spouse received \$160 and the other \$70 in ordinary dividends, the exclusion would be limited to \$170 since one cannot use the other's excess of exclusion over dividends received.

Chapter 11 in Publication 17 gives the reader a detailed discussion of dividends and other corporate distributions.

## Interest—Schedule B

All interest is taxable except excluded interest on certain State and municipal obligations. Interest on obligations of the United States is fully taxable. This includes the interest on tax refunds and U.S. Bonds.

Most taxpayers elect to defer reporting interest on U.S. Savings Series E Bonds until the bonds are matured or cashed. However, it is permissible to report the interest each year by including in income the increase in redemption value.

Other types of fully taxable interest income include:

(1) Interest on savings and other bank deposits.

*Note:* The fair market value of automobile, boat, or other property received for making long-term deposits or for opening accounts in savings institutions is interest and must be reported as income in the year received.

(2) Interest on notes, mortgages, corporate bonds, and debentures.

(3) Interest portion of a condemnation award.

(4) Interest on legacies.

(5) Interest on life insurance proceeds held under an agreement to pay interest thereon.

(6) Interest on Veterans Insurance—If the taxpayer elects to leave the insurance dividends on deposit with the Veterans Administration, the interest paid or credited on the accumulated dividends is includible in gross income. Note that it is not the dividends but the interest on such dividends that is taxable.

(7) Interest on Armed Forces leave bonds, or on payments for leave.

(8) Interest received on Soldiers' Deposits when withdrawn or made available for payment, whichever is earlier.

(9) Interest sometimes called "dividends" received from Mutual Savings Banks, Cooperative Banks, Credit Unions, Building and Loan Associations, and Savings and Loan Associations.

(10) Foreign sourced interest unless excluded by Treaty.

Interest is taxable when it is received. The interest on savings accounts is considered received when it is creditable to a taxpayer's account and subject to withdrawal even though it has not yet been entered in the passbook.

## Tax-Exempt Interest

Interest on obligations of a State, or a political subdivision thereof is wholly tax-exempt. This includes such bodies as Port Authorities, Toll Road Commissions, Utility Service Authorities, and other similar bodies created for furtherance of public functions. It also includes State and Municipal Bonds purchased at a discount and Obligations of the District of Columbia, Puerto Rico, a possession of the United States, or a political subdivision thereof.

## Capital Gains and Losses—Schedule D

Included in the concept of gross income are gains

resulting from dealing in property. Some situations surrounding the receipt of gross income give rise to a special treatment of such income. The special treatment is afforded gains and losses resulting from dealings in property.

For sales or other dispositions of property, a determination must be made as to whether the gain or loss should be included in or deducted from income in the usual manner—that is, as ordinary income or loss—or whether a special treatment is in order.

For the purpose of this course the term "sale" means the transfer of property for money only, or for a promise to pay money, such as a note. An "exchange" is a transfer of property for other property.

## General Rules

A gain from a sale or exchange of property is, generally, income in the amount of the difference between the amount realized and the taxpayer's cost of the property. This gain is ordinarily taxable whether the property disposed of is business or nonbusiness.

A loss on the sale or exchange of business property is, generally, deductible in the amount of the difference between the taxpayer's adjusted basis of the property and the amount realized (sale of rental property). A loss on the sale or exchange of property held for personal use is not deductible (sale of a personal residence).

The amount of a taxpayer's taxable gain or deductible loss depends upon the nature of the asset sold or exchanged to produce the gain or loss and the length of time it was held. Ordinarily, business gains and losses are usually includible in income or deductible in full, but capital gains and capital losses are subject to special rules and limitations.

## What Are Capital Assets

All assets which are sold or exchanged have to be classified as: (1) capital assets, (2) noncapital assets, or (3) assets which may be treated as either capital or noncapital depending on the circumstances.

Capital assets are everything an individual owns, except:

- (1) Stock in trade (assets in inventory);
- (2) Property held for sale to customers in the ordinary course of the taxpayer's trade or business;
- (3) Notes receivable and accounts receivable;
- (4) Depreciable business property;
- (5) Real property used in taxpayer's trade or business;
- (6) A copyright, a letter or memorandum, a literary, musical or artistic composition or similar property (but not a patent or invention) held by the taxpayer who created it;
- (7) Certain short-term government obligations.

Note that stocks, bonds and personal residences can normally be classified as capital assets.

## Computation of Capital Gain or Loss

### Net Long-Term Capital Gain

All capital gains and losses, both long-term (from sale or exchange of capital assets held over six months)



and short-term (from sale or exchange of capital assets held six months or less), are initially taken into gross income at 100%.

If net long-term capital gain exceeds net short-term capital loss, a deduction of 50% of the excess is allowed. If there is no net short-term capital loss, the deduction allowed is 50% of the net long-term capital gain.

*Example.* On 6 July taxpayer sold for \$3,600 stock which he had purchased on 6 March, for \$4,800. The \$1,200 is a short-term capital loss since the stock had not been held for more than six months.

On 20 July he sold for \$10,000 stock which he had purchased on 5 January for \$7,500. The long-term gain is \$2,500.

On 3 August he sold for \$3,000 stock which he had purchased on 1 March, for \$2,800. The short-term capital gain is \$200.

On 16 December he sold for \$5,700 stock which he had purchased on 2 February for \$6,400. The long-term capital loss is \$700, since the stock has been held for more than six months.

#### Reported on Schedule D, Part I

(1) Short-term loss	.....	(\$1,200)
Short-term gain	.....	200
Net short-term (loss) (Schedule D, Part I)	..	(\$1,000)

#### Reported on Schedule D, Part II

(2) Long-term loss	.....	( 700)
Long-term gain	.....	2,500
Net long-term gain (Schedule D, Part II)	..	<u>1,800</u>
(3) Excess of net long-term gain over net short-term loss (Schedule D, Part III)	..	\$ 800
(4) Deduction—50% (Schedule D, Part III)	..	<u>( 400)</u>
(5) Taxable portion (Schedule D, Part III)	....	<u>\$ 400</u>

#### Net Short-Term Capital Gain

A net short-term capital gain is taken into income at 100%, unless it is reduced by net long-term capital losses.

*Example:*

(1) Net short-term capital gain (Schedule D, Part I)	.....	\$1,500
(2) Net long-term capital gain (Schedule D, Part II)	.....	<u>1,000</u>
(3) Net capital gain (Schedule D, Part III)	..	<u>\$2,500</u>
(4) Less: (1) 50% of excess of long-term gain over short-term loss or (2) 50% of long-term gain whichever is smaller (50% of \$1,000 minus zero)	.....	<u>(500)</u>
(5) Taxable portion (Schedule D, Part III)	....	<u>\$2,000</u>

#### Capital Losses—Short-Term and Long-Term

If the net capital losses exceed the net capital gains, the deductible loss is limited to the smallest of the following amounts:

- (1) Taxable income for the year,
- (2) \$1,000.00, or
- (3) Net capital loss, which is the sum of
  - (a) the excess of the net short-term capital losses over the net long-term capital gains,

- (b) one-half of the excess of net long-term capital loss over net short-term capital gain, and
- (c) the net short-term capital loss plus half the net long-term capital loss.

*Illustration.* Mr. A. in 1975 has taxable income of \$10,000 and net long-term capital losses over net short-term capital gains of \$1,800. He could deduct the smallest of (1) \$10,000 (2) \$1,000 or (3) \$900 (½ of \$1,800). Since \$900 is the smallest, his deduction of capital losses against ordinary income would be limited to \$900.

*Illustration:* If his net long-term capital losses over net short-term capital gains were \$5,000, he could deduct a full \$1,000, under number (2) because number (3) would be raised to \$2,500 and number (2) would be the smallest.

The \$1,000 loss offset to ordinary income is on a per-return basis. If a joint return is filed, the \$1,000 limit applies to both the husband's and wife's combined losses.

If married persons file separate returns and both have capital losses, they are limited to a \$500 deduction for each return.

#### Capital Loss Carryover

If capital losses are in excess of the limitations listed above, the excess may be carried over to subsequent years until it is completely absorbed. When carried over, the loss will retain its original character as long-term or short-term; thus, a long-term capital loss carried over from a previous year will offset long-term gains of the current year before it offsets short-term gains of the current year.

When carrying over an unused long-term loss, 100% of the loss is carried to the next year and is treated as if it were incurred in that year. An individual's capital loss carryover is computed on Form 4798.

*In determining the capital loss carryover,* short-term losses are applied first, even if they are incurred after a long-term loss. If, after applying the short-term loss, the limitations previously described above have not been reached, apply the long-term losses until the limit has been reached. Since long-term losses are only deducted at 50%, twice the amount needed to reach the limitation represents the long-term loss which may still be deducted.

*Example:* On A's 1975 return his capital loss deduction limit is \$1,000 and he realized short-term losses of \$400 and long-term losses of \$2,300. His carryover to 1976 is computed as follows:

(1) Maximum amount of capital loss deduction	..	\$1,000
(2) Less: Short-term capital loss	.....	400
(3) Remaining available capital loss	.....	<u>\$ 600</u>
(4) Long-term capital loss	.....	<u>\$2,300</u>
(5) Amount needed to reach \$1,000 limitation at 50% (Line 3 \$600 × 2)	.....	<u>1,200</u>
(6) Long-term capital loss carryover to 1976	....	<u>\$1,100</u>

**Pre-1970 Long-Term Capital Losses**—Net long-term capital losses carried over from a year beginning before 1970 are not subject to the reduction by 50% for long-term capital losses applied against \$1000 of ordinary income each year. These carried over long-term losses, to the extent not offset against net capital gain, are deductible dollar for dollar up to \$1,000 against ordinary income for years beginning after 1969. They must also be deducted before any net long-term capital losses occurring in 1970 and later years.

### Computation of Alternative Tax

It may be to the taxpayer's advantage to use the alternative tax computation shown on Schedule D, Part VI, page 2, if the net long-term capital gain exceeds the net short-term capital loss, or if there is a net long-term capital gain only, and if the taxpayer is filing.

- (a) a separate return from one's spouse with taxable income exceeding \$26,000, or
- (b) a joint return, or as a surviving spouse, with taxable income exceeding \$52,000, or
- (c) as a single taxpayer or head of household with taxable income exceeding \$38,000.

From this you can see that the average military man need not concern himself with the alternative tax computation. If the problem does arise, follow the form on Schedule D and enter the tax computed on Schedule D, on line 16a, Form 1040, and check Schedule D box.

### Additional Schedule D Transactions

Two Transactions, common to military personnel, which are reflected on a Schedule D are:

- (1) The sale of corporate stock.
- (2) The sale of a residence.

Chapters 28 and 30 in the Publication 17 give an excellent tax return presentation of these transactions.

### Sale of Corporate Stock

Three tax aspects must be considered in computing the gain or loss on the sale of stock.

- (1) The basis
- (2) The selling price
- (3) The holding period

#### Basis

The basis of *purchased* stock is its cost to the purchaser. This may be obtained from a brokerage advice slip which should be kept to substantiate the basis. The cost includes brokerage fees, tax and any other cost of acquisition. The cost of purchased stock is the basis regardless of whether the disposition results in a gain or loss.

The basis of *inherited* stock will generally be its fair market value at the date of the decedent's death (or at the alternate valuation date). Such basis is used regardless of whether the disposition results in a gain or a loss.

To determine the taxpayer's basis of property acquired by gift, he must know its adjusted basis to the donor, its fair market value at the time of the gift, and the amount of gift tax paid.

#### Fair Market Value Less Than Donor's Adjusted Basis

If the property was given to the taxpayer and its fair market value at the time of the gift was less than the adjusted basis to the donor just before the gift, his basis for depreciation, depletion, or amortization, and for gain on its sale or other disposition is the same as the donor's adjusted basis. The taxpayer's basis for loss is its fair market value at the time of the gift. If he uses the basis for determining gain and computes a loss, and then uses the basis for determining a loss and computes a gain, he will have neither a gain nor a loss.

#### Fair Market Value Greater Than Donor's Adjusted Basis

If the property was given to the taxpayer and its fair market value at the time of the gift was greater than the donor's adjusted basis just before the gift, his basis for depreciation, depletion, or amortization, and for gain or loss on its sale or other disposition is the donor's adjusted basis at the time of the gift, increased by the gift tax paid with respect to the gift to him but such basis is limited to the fair market value of the property at the time of the gift.

#### Selling Price

The selling price of a security can easily be ascertained by reference to the broker's advice slip which the taxpayer should keep to substantiate the sale. The price is the net amount which would be received by the taxpayer resulting from the completed transaction (market price less broker's fee and any other selling expenses). This amount is reflected on Schedule D, Part I or Part II.

#### Holding Period

To determine if the taxpayer held property over 6 months he should begin counting on the day following the day he acquired the property. This same day of each succeeding month is the beginning of a new month regardless of the number of days in the preceding month. In his computation he should include the day he disposed of the property. For example, if he purchased an asset on 4 January, he should start counting on 5 January and the 5th of each succeeding month is the beginning of a new month. Thus, if he sold the property on 4 July, his holding period would not be over 6 months. If he sold it on 5 July, his holding period would be over 6 months.

#### Exception

(1) If the taxpayer receives a *gift* of property, and if his basis is determined by reference to the basis in the hands of the donor, the first day of his holding period is the same date which the donor used in computing his holding period.

(2) *Capital gain dividends from mutual funds* are treated as long-term capital gains regardless of how long the taxpayer owned the stock in the mutual funds.

### The Sale of a Residence

#### General Rule

The sale of a personal residence is treated as the sale of a capital asset subject to taxation. However, the tax



is postponed, but not forgiven if a new principal residence is purchased and occupied by the taxpayer within 18 months before or 18 months after the date of sale of the old residence and if the cost of the new residence equals or exceeds the "adjusted sales price" of the old residence. The 18-month period may be extended to 24 months when the taxpayer constructs or builds a new principal residence to replace the old residence. Construction must begin either 18 months before the date of sale of the old residence or not later than 18 months after the sale, and the taxpayer has 24 months after the date of sale in which to occupy and use the new residence as a principal residence. The 18-month or 24-month period after sale is suspended during the time a member serves on active duty (pursuant to a call or order for a period over 90 days or for an indefinite period) except that the total period shall not extend beyond 4 years after the sale of the old residence. However, if a member is in a combat zone, the running of the 4-year period is suspended during the time of such service, and for the next 180 days thereafter.

If within the 18-month (or 24-month) period a taxpayer buys more than one residence which he uses as his principal residence within 18 months after the sale of the old residence, only the last such residence constitutes the new residence for purposes of postponing taxing the gain. Any other principal residences bought during this period will be treated as ordinary capital assets subject to taxation.

The taxpayer will not be denied the benefit of this provision simply because he did not actually occupy the old residence on the date of sale or because it had been temporarily rented prior to the sale. The question whether a residence was converted to rental property or remained a principal residence must be determined upon the facts and circumstances in each case, including the good faith of the taxpayer, and a showing that his intention, up to the time of sale, was to reoccupy the property as his residence.

A houseboat or trailer may qualify as your principal residence if you actually live in it. A condominium or cooperative apartment may also qualify as your principal residence if you are the title owner or shareholder, and if you use as your principal residence the apartment which you are entitled to occupy by reason of your ownership.

See Chapter 5 for the discussion of the 5% credit on purchase of a new principal residence.

### The Computation

*A loss on the sale of a principal residence is not deductible and will not have any effect on the basis of any new residence acquired.*

If the residence is sold at a gain and the individual has bought or intends to buy, at the time of filing, a new home for more than the adjusted sales price of the old one, the sale is reported on Schedule D with a notation "none" in column (f). If upon expiration of the specific period a new home has not been purchased or one has been purchased for a lesser amount, the return for the year of sale should be amended to report the profit and compute the additional tax plus interest.

However, if the purchase price of an old home is

somewhere between the basis of the old home and the sales price of the old home, the individual would be taxed on only a portion of the total gain. That portion not taxed is a reduction in the basis of the new residence. This somewhat complex computation of the taxable and nontaxable gain in this situation is best computed on Form 2119.

The adjusted sales price of the old residence is usually the same as the amount realized. However, "fixing-up" expenses are deducted from the amount realized to determine the adjusted sales price.

"Fixing-up" expenses must meet the following tests:

(1) Be for work performed during the 90-day period ending on the day on which the contract to sell was made.

(2) Paid within 30 days after the date of sale.

(3) Be otherwise nondeductible in computing taxable income.

(4) Not be capital expenditures or improvements, and

(5) Not be taken into account in computing the amount realized.

"Fixing-up" expenses are considered only in determining the amount of gain on which tax is postponed. They are not deductible in determining the actual profit on the sale of the old residence.

### Special Rule-Taxpayers 65 or Older

An individual may elect to exclude from gross income any gain attributable to the first \$20,000 of the adjusted sale price of his personal residence if he was 65 or older before the date of the sale or exchange and if the property has been owned and used by him as his principal residence for a period of time totaling at least 5 years during the 8-year period ending on the date of such sale. If the adjusted sale price was \$20,000 or less, and the taxpayer elects this exclusion, his gain is never taxed. If the adjusted sale price exceeds \$20,000, only the proportion of the gain in the ratio which \$20,000 bears to the total adjusted sale price is excludable. However, the rules discussed above for the postponement of tax on the qualifying balance of the gain may be applicable. The election to exclude such gain can only be made once in a lifetime.

### Alimony

Receipts of periodic payments for alimony or separate maintenance are generally included in income\* if they are paid under:

(1) A decree of divorce or separate maintenance,

(2) Written separation agreement, or

(3) Decree for support

If a divorce decree provides for both alimony and "child support," only that portion so designated as alimony is taxable. If no separate amount is stated for either alimony or "child support," the full amount is considered as alimony. Income from alimony is reported on Form 1040, Part I, line 34.

### Miscellaneous Income

Form 1040, Part I, Line 35 (Other) reflects the following types of income:

## Prizes and Awards

Prizes and awards are taxable in the year they are received. They are not considered nontaxable gifts. If they are paid in merchandise or services they are included in income at their fair market value. Contest awards, employee suggestion awards, door prizes, lucky number, etc., are taxable. However, if an individual refuses to accept a prize it is not included in his income.

## Gambling Winnings

A taxpayer's total winnings must be included in income. He may deduct his losses from gambling only to the extent of his winnings and provided he itemizes his deductions. Proceeds from lotteries and raffles are gambling winnings to the extent of the excess of the proceeds over the cost of the ticket. Winnings in other than cash are included in income at their fair market value.

## Hobby Income

Income from a hobby, including a farm operated for recreation and pleasure, must be included in the taxpayer's return. From this income, he may deduct items that are ordinarily deductible, whether incurred in a business or nonbusiness activity. Examples of such expenses are interest and taxes. If his income exceeds these expenses, he may deduct the following expenses, in the order shown, but only to the extent of the excess:

(a) Interest and taxes, determined without regard to the profitability of the activity;

(b) Operating expenses (except those in (c) below) to the extent gross income exceeds deductions allowable under (a) above; and

(c) Depreciation and other expenses involving adjustments to the basis of property to the extent gross income exceeds deductions allowable under (a) and (b) above.

To the extent that his normally deductible expenses (such as taxes and interest) exceed the hobby income, that excess may be carried over from the appropriate schedule (such as Schedule E for rental income) and deducted on Schedule A (Form 1040) if he itemizes his deductions.

Losses sustained in pursuing the hobby are not deductible.

*Note:* Gain on sale of an entire stamp, coin or other hobby object collection is taxable as a capital gain; the loss on such sale is *NOT* deductible.

## Rewards

Compensation for special services, such as preventing a bank robbery or informing on an income tax violator, must be included in the gross income of the one rewarded.

## Services of a Child

Compensation for personal services of a child is gross income to the child and not the parent even though such amounts are not received by the child.

## Assigned Compensation

A taxpayer who has the right to receive income may not escape tax thereon by arranging to have payment made to another individual. By exercising his power to command the income, the taxpayer has enjoyed the benefit of it and must include such amounts in this gross income.

## Post Exchange Income

Income earned by a U.S. citizen from services performed in a post exchange or officers' club located in either the United States or a foreign country is taxable; indeed, income earned from all nonappropriated fund organizations is taxable.

## For the Following Types of Income, See Publication 17

Pension and Annuities, Chapter 13

Partnership, Estate and Trust Income, Chapter 7.

## Summary

### Income Defined

Gain from capital, labor or both provided it includes profit gained through sale or conversion of capital assets.

### Form of Income

- (1) Money—at face value
- (2) Property—at F.M.V.
- (3) Services—at F.M.V.

### What Military Pay Is Found on W-2

- (1) Basic pay
- (2) Incentive pay
- (3) Special pay
- (4) Lump-sum payment for accrued leave
- (5) Reenlistment bonus
- (6) Severance pay
- (7) Readjustment pay
- (8) Dislocation allowance

*Note:* Attach W-2's to return. Enter total of all W-2's on line 9 of Form 1040 or line 9 of Form 1040A if this form can be used.

### Income From All Sources Other Than Wages

Form 1040, lines 10, 11 and 12 are used to report all other income other than wages, tips, etc.

Form 1040A, lines 10 and 11 are used to report dividends and interest. Except for these two items of income no other income other than salaries, wages, tips and other employee compensation can be reported on Form 1040A.

### Dividends

#### Types

- (1) Ordinary dividends—taxable
- (2) Return of capital—nontaxable

- (3) Capital gains—from mutual funds—Schedule D
- (4) Tax free dividends [\$100 exclusion of qualifying dividends (domestic corporations)]

#### Stock Dividend

- (1) Taxable if in lieu of cash
- (2) Nontaxable if not. (Spread cost of old stock to include stock dividend)

#### Dividends on Insurance Policy

- (1) Nontaxable—since they are a partial return of nondeductible premiums.

*Note:* Interest on such dividends is taxable as interest

#### Dividends From Mutual Funds

- (1) Ordinary dividends
- (2) Capital gains dividends—Long term no matter what.

*Note:* Company should so designate between ordinary and capital gains.

#### Savings and Loan Dividends

Interest not dividend income.

#### Interest

- (1) *Types of interest includible in gross income*

- (a) Savings bank
- (b) Notes, mortgages, bonds
- (c) Interest on life insurance proceeds
- (d) Interest on Veterans Insurance
- (e) Armed Forces leave bonds
- (f) Soldier's Deposits
- (g) Mutual Savings banks, Cooperative banks, Credit Unions, Bldg. & Loans Assns. and Savings and Loan Assns.
- (h) U.S. Government bonds.

(2) *Interest taxable* when creditable to passbook even though the bookkeeping entry has not been made.

(3) *Tax Exempt Interest*—Obligations of a State or political subdivision thereof.

*Note:* Reference for further study—Pub. 17, Chapter 10.

#### Gains and Losses From Sales and Exchanges

##### Gain on Sale

A gain from a sale or exchange of property is, generally, income in the amount of the difference between the amount realized and the taxpayer's cost of the property. This gain is ordinarily taxable whether the property disposed of is business or nonbusiness.

##### Loss on Sale

Loss on sale of business property is generally deductible. (Rental Property)

Loss on sale of a personal asset is nondeductible. (Personal Residence)

#### What are Capital Assets

Everything an individual owns except

- (1) Stock in trade
- (2) Property held for sale to customers.
- (3) Notes and accounts receivable.
- (4) Depreciable business property.
- (5) Real property used in taxpayer's business.
- (6) Copyright, a letter or memorandum, literary, musical or artistic composition held by the taxpayer who created it.

Stocks, bonds, personal residences are usually capital assets in the hands of military personnel.

#### Computation of Capital Gain or Loss

- (1) Review Schedule D, Part I and II (Capital Assets).

(2) Short-term capital gain is the gain from the sale or exchange of capital assets held six months or less.

(3) Long-term capital gain is the gain from the sale or exchange of capital assets held over six months.

(4) Note tax advantage given the excess of long-term gains over short term losses (50% nontaxable portion—Section 1202 deduction).

(5) If net capital losses exceed net capital gains the deduction is limited to the lesser of:

- (a) the taxable income for the year,
- (b) \$1,000.00, or
- (c) the net capital loss.

(6) Computation of Alternative Tax—see Schedule D for benefit.

(a) separate return—taxable income must exceed \$26,000

(b) joint return—taxable income must exceed \$52,000

(c) single taxpayer or head of household—taxable income must exceed \$38,000

*Note:* Will not normally apply to servicemen.

#### Sale of Corporate Stock

##### Basis

- (1) Purchased—Cost
- (2) Inherited—Estate Tax Return Basis
- (3) Gifted—Donor's basis

#### Sale of a Portion of Holdings

Selling a block of stock by *actual security number* to get the highest basis—otherwise sales are treated on first-in first-out basis as far as cost is concerned.

##### Selling price

Use broker's advice slip to determine selling price.

##### Holding period to determine long or short-term gain

- (1) 1st day is the day after purchase or acquisition.
- (2) The same day on each succeeding month is the beginning of each new month.
- (3) The day of disposition should be included in computation.

### Exception

(1) For gifted property holding period begins with that of the donor.

(2) Capital gains from mutual funds or regulated investment companies are long term even though the taxpayer owned the stock of the mutual fund 6 months or less.

### Sale of a Residence

#### General Rule

- (1) Gain—capital gain
- (2) Loss—nondeductible

#### Tax postponed but not forgiven if

(1) New principal residence is purchased and occupied within 18 months before or 18 months after the date of sale of the old residence and if the cost of the new one equals or exceeds the adjusted selling price of the old one.

*Note:* The 18 month period is extended to 24 months when the taxpayer builds or contracts for a new house within 18 months and occupies within 24 months.

(2) *Adjusted selling price means* selling price less selling expenses (commissions, advertising and work performed in fixing-up the old residence for sale).

(3) *Basis* of new residence is cost minus postponed gain on the sale of the old residence.

(4) *Holding period* of old residence is added to that of new residence for determining short or long-term gain on future sale of new residence.

(5) If adjusted sales price of old residence exceeds cost of new one, the gain taxed is limited to lesser of

- (a) Gain realized on sale of old residence.
- (b) Excess of adjusted sales price of old residence over the cost of the new one.

#### Special Rule

Taxpayer 65 or older before date of sale of old residence.

Excludes gain attributable to first \$20,000 of adjusted sale price provided the property has been owned and used by him as a principal residence for at least 5 years during the 8 year period ending on the date of such sale.

*Note.* If adjusted sale price was \$20,000 or less—gain is never taxed—if more, only the proportion of the gain in a ratio which \$20,000 bears to the total adjusted sale price is excludable.

This is a once in a lifetime exclusion.

### Alimony

Periodic payments for alimony or separate maintenance are taxable when paid under:

- (1) Decree of divorce or separate maintenance
- (2) Written separation agreement
- (3) Decree for support

*Note:* Child support is not taxable.

Where no stated amount is for alimony and child support it is all considered alimony.

### Miscellaneous Income

#### Reflected on Form 1040, Part I, Line 35

- (1) Prizes and awards.
- (2) Gambling winnings.
- (3) Hobby income—losses not deductible. Sale of stamp collection may be capital gain.
- (4) Rewards—informer's claim, etc.
- (5) Services of a child—taxable to child even though not received by him.
- (6) Assigned compensation—taxpayer who has the right to receive income cannot assign such right, e.g., parent owns stock, he cannot assign dividends to a child.

### Quizzes for Chapter 3

#### Multiple Choice Quiz

*Directions*—Circle the appropriate letter to select the answer to each of the following questions.

1. Gross income does not include
  - A. savings account interest
  - B. rents
  - C. commissions
  - D. unrealized increases in value of property
  - E. alimony and separate maintenance payments.
2. R, a single person, received the following: wages \$2,000; interest \$100; bonus paid in corporation stock valued at \$475; rents \$100; and a prize from a TV quiz program valued at \$200. R's gross income is
  - A. \$5,100. B. \$5,300. C. \$5,400. D. \$5,775. E. \$5,875.
3. R served as a private in the U.S. Army for 4 months. He received the following compensation for this service: total base pay for the period, \$600; pay for hazardous duty, \$100; severance pay, \$200; and a nondisability pension of \$800. R's gross income is
  - A. \$800. B. \$900. C. \$1,400. D. \$1,600. E. \$1,700.
4. On 1 June, T, in lieu of giving his son an allowance, assigned his right to all dividends on 100 shares of stock owned by him in the Mortality Life Insurance Company (a Canadian corporation). During 1975, equal quarterly dividends of \$2 per share, payable January 15, April 15, July 15, October 15 were paid by the company. T's gross income for this source is
  - A. \$800. B. \$600. C. \$400. D. \$200. E. nothing.
5. On 5 January 1974, M opened a savings account with a local bank by depositing \$3,000. Another \$3,000 was deposited on 5 January 1975. Interest of \$150 was credited on his account on 31 December 1974, and interest of \$304.50 was credited to his account on 31 December 1975, but were not entered in passbook. On 10 January 1976, M withdrew the entire balance in his account including interest. What amount and in which year should the interest be included in gross income?
  - A. \$150.00 in 1974 and \$304.50 in 1975
  - B. \$454.50 in 1975
  - C. \$304.50 in 1973 and \$150 in 1975



D. \$150.00 in 1975 and \$304.50 in 1976

E. \$454.50 in 1976

6. M received the following amounts called dividends by the payor: City Mutual Savings Bank, \$200; Car-Motor Co., \$400, X Domestic Savings and Loan Association, \$500; U.S. Talk Co., \$100. In addition M receives interest from a savings account at a local bank of \$200. Assuming that all dividends are fully taxable, M must include as income from dividends
- A. \$1,400. B. \$1,300. C. \$700. D. \$500. E. None of these.
7. All but one of the following are includible in gross income. Select the EXCEPTION
- A. Cash dividends distributed by a domestic corporation  
B. Property distributed in lieu of cash by a domestic corporation  
C. State lottery winnings  
D. Cash dividends paid by mutual insurance companies  
E. Interest on refund of Federal taxes
8. H and W, husband and wife, were divorced. The wife was awarded the custody of their minor daughter by the court. Under the court decree the husband is to pay his former wife \$275 a month for the support of herself and the minor daughter. The wife received a total of \$3,300 for this purpose, \$900 of which was designated by the decree to be for the support of the minor daughter. In addition W received from H \$500 for medical bills incurred by the daughter. This payment was not required under the terms of the court decree. W must include in her gross income.
- A. \$3,000. B. \$3,300. C. \$2,400. D. \$900. E. \$500.

### Quiz

1. John Smith operates a variety store and owns the following property: (indicate by an "X" in the appropriate box whether such property is a capital or noncapital asset in the hands of Smith.)
- a. An automobile used solely for pleasure.  
 Capital  Noncapital
- b. His private residence.  
 Capital  Noncapital
- c. The building housing his variety store.  
 Capital  Noncapital
- d. 100 shares of American Talk stock.  
 Capital  Noncapital
- e. An apartment building.  
 Capital  Noncapital
- f. An automobile used solely to run business errands.  
 Capital  Noncapital
- g. A diamond ring, which is a family heirloom.  
 Capital  Noncapital
- h. 16 bicycles which have been in store inventory for at least one year.  
 Capital  Noncapital
- i. 12,000 board feet of lumber with which he intends to build a hunting lodge for his son and himself

- Capital  Noncapital
- j. The vacant lot next to his store which is used as a parking lot for his customers.  
 Capital  Noncapital
- k. The copyright to a song he wrote.  
 Capital  Noncapital
- l. A note receivable which was given to him by a customer in payment of the balance on the customer's charge at the store.  
 Capital  Noncapital
2. Indicate by a check whether the following statements are true or false.
- a. The alternative tax computation should be made by each taxpayer who has capital gains, regardless of the amount of his taxable income.  
 True  False
- b. Short term capital gains or losses arise from the sale or exchange of capital assets which have been held for six months or less.  
 True  False
- c. A loss sustained on the sale of a taxpayer's principal residence which has been used as such up to the date of the sale, is deductible within certain limitations.  
 True  False
- d. A 65 year old taxpayer selling in 1975 his principal residence in which he had lived for the past 8 years may elect to exclude from gross income all gain on the sale if the adjusted sales price does not exceed \$20,000.  
 True  False
3. Fair market value generally represents the amount which an owner, who is not under a necessity of selling, is willing to take and which another person, who is not under a necessity of buying, is willing to pay.  
 True  False
4. While the loss on the sale of a personal residence is not deductible, the amount of the loss may be added to the cost of the new residence.  
 True  False
5. Sergeant Spruce won \$100 at the races in January. He returned to the track and lost \$50 in December. He is claiming the standard deduction on his return. He should report \$50 as "miscellaneous income."  
 True  False

### Continuing Problem

#### Part 1—Income

Enter the following information in appropriate spaces on Form 1040, and compute the taxable portion of dividends. Do not compute the income tax.

Save the Form 1040 to be added to later.

John A. Mankat, 1st Lt., USAF Soc. Sec. No. 218 36 5387

Wife: Betty Mankat (Secretary) Soc. Sec. No. 218 42 3678

John received:

Salary, USAF .....	\$8,550.00
Dividends, X Corp. ....	150.00
Dividends, ABC Fund: Ordinary .....	118.00
Dividends, ABC: Capital gains dividend .....	15.00

Dividends, German industries, GmbH, Frankfurt.	
DM100.00 at 43¢ = .....	43.00
Interest, 1st National Bank .....	200.00
Interest, Municipal Bond .....	60.00
Betty received:	
Salary, USAF .....	4,798.00
Dividends, US Talk .....	150.00

**Part 2—Income**

From the following information, prepare a Schedule D, taking into account the capital gain dividend from

Part 1 of the problem. When Schedule D is completed, carry the result to line 29(a), Form 1040.

John A. and Betty Mankat

John A. Mankat sold 100 shares of X Corp. common stock on 16 May 1975 at a gross sales price of \$2,800.00. He paid a broker's commission of \$100.00 on the sale.

He had purchased the stock on 20 April 1960 for \$1,000.000.

# Chapter 4. Exclusions and Deductions to Arrive at Adjusted Gross Income

## Introduction

In previous chapters, consideration was given to the various types of includible income.

This chapter discusses the items which are excludable or deductible from gross income in arriving at adjusted gross income (Form 1040, line 15). Such items include combat zone exclusion, prisoner of war exclusion, sick pay exclusion, subsistence and quarters allowance, moving expenses, certain travel expenses, and life insurance proceeds. The subject matter is broken down into two parts:

(1) Excludable or deductible items received from the Armed Forces

(2) Excludable items from other sources

The computation of adjusted gross income must be accurate since the following items are computed in accordance with its amount:

- (1) Income tax liability from the optional tax table
- (2) The percentage standard deduction
- (3) The maximum contribution deduction
- (4) The medical expense deduction

The relevant "adjustments" contained on Form 1040, line 14 are covered in detail in this section of the course, so that after studying Chapter 4, the student should know what taxpayer's adjusted gross income consists of, i.e., wages, plus other income, minus adjustments.

*Note.* In deducting certain eligible items discussed in this chapter from gross income, Form 1040 must be used. These items are not deductible on Form 1040A.

## Objectives

Participants should be able to explain the following concepts:

(1) Those items of income which are excludable or deductible from gross income in arriving at adjusted gross income (Form 1040, line 15).

(2) The use of Forms to support adjustments.

Applicable forms for this chapter include:

*Form No.*

3903 Moving Expenses Adjustment

2106 Employee Business Expenses

2240 Sick Pay Exclusion

## Excludable or Deductible Items Received From the Armed Forces

### Service in a Combat Zone (and Prisoners of War or Missing)

An enlisted member does not have to pay tax on wages for any month during which he served in a combat zone or qualified for Hostile Fire Pay. Furthermore, he does not have to include wages received while in a hospital because of injuries or sickness resulting from combat zone service.

A commissioned officer does not have to pay tax on

the first \$500 he received for any month during which the member served in a combat zone or qualified for Hostile Fire Pay. Also he does not have to pay tax on the first \$500 a month received while hospitalized for sickness or injury resulting from combat zone service.

This exclusion ceases for any month beginning more than two years after termination of combatant activities. In the case of the Vietnam conflict, the exclusion for a service member who is hospitalized as the result of combat zone service ceases to apply to any month beginning more than two years after January 2, 1975.

The pay of members of the Armed Forces and civilian government employees, during the time they were prisoners of war or missing in action because of the Vietnam conflict, is not taxed.

Accrued leave payments, attributable to active service in a combat zone, paid to members of the Armed Forces at the time of their discharge from the service are excludable from gross income.

### Hostile Fire Pay

Members of the Armed Forces who perform military service in an area outside an area designated as a combat zone by executive order, which service is in direct support of military operations in such zone and is performed under conditions which qualify such members for Hostile Fire Pay (as authorized under section 9(a) of the Uniformed Services Pay Act of 1963 (37 U.S.C. 310)), will, during the period of such qualifying service, be deemed to have served in such combat zone. Accordingly, he is entitled to the combat pay exclusion for the period of service.

### Limitation to Above Excludable Items

For periods after November 11, 1970, Armed Forces members who (a) are present in a combat zone while on leave from a duty station located outside a combat zone, (b) pass over or through a combat zone during the course of a trip between two points both of which lie outside such a zone, or (c) are present in a combat zone solely for their own personal convenience, are not considered to have served in a combat zone and are not entitled to the combat pay exclusion.

### Prisoner of War Exclusion

A member of the Armed Forces is entitled to exclude all compensation received for active service for any month during any part of which such member is a prisoner of war or in a missing status as a result of the Vietnam conflict if immediately before such status began he was performing service in Vietnam or was performing service in Southeast Asia in direct support of military operations in Vietnam. The income exclusion applies to both officers and enlisted personnel.

Both POWs and MIAs are included in the term "missing." A missing serviceman is one who is officially carried, or determined to be, absent in a status of.



- (1) missing;
- (2) missing in action;
- (3) interned in a foreign country;
- (4) captured, beleaguered, or besieged by a hostile force; or

(5) detained in a foreign country against his will. An individual is in a missing status for tax purposes only if immediately before the status began he was performing service in a combat zone or was performing service in direct support of the military operations in a combat zone.

Missing status does not include a period in which it is officially determined that the member was officially absent from his post of duty without authority. This exclusion is retroactive to 28 February 1961. Claims for a refund of taxes paid for service on or after that date should be filed on Form 1040X or Form 843. The running of the statute of limitations on filing claims for refund is suspended while persons are serving in Vietnam, but even if the regular time for filing a claim for refund has expired it may be filed within two years after the missing status is terminated.

### Combat Death Waiver

The tax liability of a serviceman who dies as a result of wounds, disease, or injury sustained in a combat zone is cancelled for the year of his death and for any prior year ending on or after the first day he served in a combat zone.

The income of a serviceman listed as missing in action or as a prisoner of war in Vietnam remains exempt from Federal income tax even where the serviceman is later found to have been dead during this time. The date of death, with respect to a missing member, is considered not to be earlier than the date on which a determination of death is made. The forgiveness of tax applies through the year in which the missing status is changed rather than the year of actual death.

In the case of Vietnam, the tax forgiveness benefits end for taxable years beginning after 2 January 1977. In the case of those servicemembers in a missing status the taxes will be forgiven even though Vietnam is no longer designated as a combat zone if the date his missing status is changed is within any taxable year beginning not later than 2 January 1977.

## Compensation Other Than Active Duty Pay

### Basic Allowance for Quarters (BAQ)

The following items may be excluded from income: allowance for quarters, including cash differences for inadequate quarters, temporary lodging pending assignment of permanent quarters at a new post of duty outside the continental United States; housing and cost-of-living allowances abroad whether paid by the United States or a foreign government; uniform allowances; or quarters, heat, and light furnished in kind; and, to the extent expended for the purpose for which provided, evacuation allowances.

### Basic Allowance for Subsistence (BAS)

Allowances for subsistence, including R.O.T.C. subsistence, and rations furnished in kind to enlisted members are excludable.

A "family separation allowance", received by a member who is separated from his family because of an overseas duty assignment, is a subsistence and commutation of quarters allowance and is excludable from his gross income.

### Moving Expenses

On changes of permanent duty or station, or upon reporting for active duty, or upon employment at a new location requiring a change of principal residence, a member of the Armed Forces is entitled to deduct from his gross income certain reasonable expenses incurred in the transfer subject to certain time and distance requirements and dollar limitations. The taxpayer may deduct his allowable moving expenses even if he does not itemize his deductions. All reimbursements (including mileage and per diem) must be reported on the taxpayer's return in the manner as explained later.

(1) *Distance and Time Requirements*—To be eligible for the moving expense deduction, the distance between the new duty station or place of work and the former residence must be at least 50 miles farther than the distance between the former residence and the former duty station. Therefore, if the distance between the former residence and the former duty station were 16 miles, to qualify for a moving expense deduction, the distance between the new duty station and former residence must be at least 66 miles. Where there was no former duty station (as when first entering the service), the first duty station must be at least 50 miles from the former residence. For purposes of the deduction, the measurement of distance between two points is the shortest of the more commonly traveled routes between the two points.

Additionally, the taxpayer must either: (1) work in the general area of the new employment full-time at least 39 weeks (need not be consecutive) in the 12-month period immediately following arrival, or (2) work full-time or perform services as a self-employed individual on a full-time basis in such general location, during at least 78 weeks, of which not less than 39 weeks are during the above 12-month period. *Note:* If a Government employee employed by the United States, returns to the United States to retire without any plan for employment during the current taxable year, the expenses incurred in the return move can not be deducted as moving expenses since the individual is not a full time employee meeting the aforementioned time requirements.

In an instance of retirement or other separation from service, the member need not work for the same employer as long as employment is in the same general location. These time requirements do not apply in situations where the member is unable to satisfy the conditions because of death, disability, involuntary separation from work (other than for willful misconduct) or transfer for the benefit of the Government. If filing a joint return, and the member's spouse is also a full-time employee in the new location, either spouse may satisfy the time requirement but the periods can not be added together.

(2) *Deductible Moving Expenses*—Below are qualifying moving expenses incurred by the taxpayer for himself and his family. For purposes of the deduction, "family" means members of the taxpayer's household who lived at the former residence before the move and moved to the new residence. A member of the taxpayer's household includes any individual residing at the taxpayer's residence who is neither a tenant nor an employee of the taxpayer, unless the tenant or employee is also a dependent of the taxpayer. From this language it can readily be seen that a member of the Armed Forces stationed overseas who returns to the United States on leave and marries while there may not deduct as a moving expense the cost of returning to his foreign station with his spouse.

The taxpayer may deduct the expenses of moving household goods and personal effects of the taxpayer and family from the former to the new residence. This includes expenses of transportation or hauling, packing, crating, intransit storage, insurance, shipping an automobile, and shipping a pet and similar expenses but does not include the expenses of moving furniture purchased while en route to the new residence. A deduction is allowed for expenses incurred in moving household goods and personal effects from a place other than the former residence only to the extent the expenses do not exceed what it would have cost to move them from the former residence.

The taxpayer is entitled to deduct the expenses of traveling (including meals and lodging) for himself and his family from the former residence to the new place of residence. Also deductible is the expense of lodging incurred in the general location of the former residence within one day after the former residence is no longer suitable for occupancy because of the removal of household goods and personal effects. Qualifying travel costs should be calculated for the shortest, most direct route available by conventional means of transportation. Expenses on vacation side trips do not qualify. When using an automobile, the taxpayer has the option of deducting actual, recorded out-of-pocket expenses (but no depreciation) or deducting seven cents per mile.

The taxpayer is entitled to deduct the cost of pre-move house-hunting trips after obtaining employment at the new site. Such deductible costs include roundtrip expenses and meals and lodging. Additionally, the taxpayer may deduct the costs of meals and lodging while occupying temporary quarters in the general location of the new principal place of work during any period of 30 consecutive days after obtaining employment.

Also qualifying as a deductible expense is the cost of selling the former residence (excluding fix-up costs and real estate taxes), settling the old lease, purchasing a new residence or acquiring a lease. This includes attorney's fees, escrow fees, appraisal, and real estate agent's fees, title and loan costs (excluding interest payments and prepayments), "points," and similar expenses incident to the sale or purchase of a home. These expenses, if deducted as moving expenses, may not be used to either reduce the amount realized upon the sale of the residence or increase the cost basis of the new residence when determining gain on the sale of a residence.

The move should be within one year from the time the taxpayer first reports to the new job. If the move

does not take place within that time, the expenses ordinarily will not be deductible.

The move must have been necessary to the commencement of work in the new location. A move is generally not necessary if the distance from the old residence to the new place of work is shorter than the distance from the new residence to the new place of work. A move is considered necessary if either the member is required to live at the new residence or commuting time or expense is decreased.

The deduction for premove househunting expenses, temporary living expenses, and qualified residence sale, purchase or lease expenses are subject to an aggregate dollar limitation. The limitation is \$2,500 of which no more than \$1,000 may be for househunting trips and temporary quarters. For an explanation of the aggregate dollar limitations for married persons filing separate returns see Publication 17, chapter 17.

(3) *Reporting Procedure*—Moving expenses are generally deductible in the year paid or incurred. However, a cash basis taxpayer may elect to deduct the expenses in the taxable year in which reimbursement is received, rather than the taxable year when he pays the expense, where the moving expenses are paid: (1) in a taxable year prior to the year of reimbursement, or (2) in the taxable year immediately following the reimbursement year, provided the expenses are paid on or before the normal due date for filing the return of the taxable year in which the reimbursement is received.

Reimbursements and allowances shown on Form W-2 are reported in gross income for year received and are reported on line 9, Form 1040. Expenses are listed on Form 3903.

If reimbursements and allowances are not shown on Form W-2 and the moving expenses exceed reimbursements and allowances, enter the excess on line 13, Form 3903 and line 38, Form 1040. If reimbursements and allowances exceed expenses, enter that excess on line 14, Form 3903 and line 35, Form 1040.

If Form 3903 is not used to report moving expenses, a statement must be attached to the tax return setting out in broad categories the type and amount of expenses, locations of old and new residences, old and new places of employment, and appropriate dates of the transfer.

Ordinarily, moving services furnished in kind by an employer, either directly or indirectly, to the taxpayer or to members of the family will be treated as reimbursements received for moving expenses. However, a serviceman was not required to account in his tax return for any reimbursement of moving expenses in kind from the Armed Forces. Servicemembers can deduct moving expenses in excess of reimbursement even if they fail because of a required service transfer to meet the 50-mile or 39-weeks requirement.

*Full-time work test not met.* If the return is due and the taxpayer has not yet satisfied the full-time work test, but expects to do so, he is given a choice as to how to claim the deduction:

(1) He may claim the moving expenses on his 1975 return. He need not wait until the date his return is due to make this election, but may elect on an early return on the basis of his knowledge at that time. If, afterwards, he fails to meet the full-time work test he must either report the amount of his deduction as income in

the year he failed to meet the test, or amend his 1975 return.

(2) He may file his 1975 return without claiming his moving expenses; if he later satisfies the test, he may either file an amended 1975 return on Form 1040X, claiming the deduction, or file a claim for refund on Form 843 based upon his allowable moving expenses deduction.

No matter which option the taxpayer may choose, any reimbursement must be reported in the year received.

## Travel Expenses

Ordinary and necessary traveling expenses in excess of allowances for travel when carrying on official business are deductible. Thus, expenses incurred on temporary or temporary additional duty, such as those incurred for meals, lodging, taxicabs, laundry, and cleaning, in excess of reimbursements, are deductible if away from home (ship, base, or station) overnight. Personal expenses incurred for entertaining, sight-seeing, or social visiting are not deductible.

The taxpayer must keep records and supporting evidence to prove the following elements with respect to deductions for traveling expenses (including meals and lodging while away from home): (1) the amount of each separate expenditure for traveling away from home such as the cost of transportation or lodging, but the daily cost of breakfast, lunch and dinner, and other incidental elements of such travel may be aggregated if they are set forth in reasonable categories, such as for meals, for gasoline and oil, and for taxi fares; (2) the date of departure and return from each trip, and the number of days spent on business away from home; (3) destination or locality of travel described by name or city or town or other similar designation; and (4) the business reason for the travel or the nature of business benefit derived or expected to be derived. If the taxpayer wishes to claim an excess of traveling expenses over reimbursement, he must compute his expenses for all such trips made during the taxable year and reduce it by all reimbursements (i.e., if he had one trip during the year which cost him more than his reimbursement, he cannot deduct such excess and forget about the other field trips made where his reimbursement may have exceeded his cost.)

Records to substantiate travel expenses should be maintained in an account book, diary, statement of expense or similar record (supported by adequate documentary evidence) which is sufficient to establish the elements for these expenditures, discussed above.

The taxpayer's records must be current. He should record each separate expenditure at or near the time of the expenditure. However, he may make one daily entry for such categories as cab fares, telephone calls, his meals while traveling, gasoline and oil, and other incidental costs of traveling. Tips may also be grouped with the cost of service rendered to him.

Documentary evidence is required to support all expenditures for lodging while he is traveling away from home and for any other expenditure of \$25 or more, except that if such evidence is not readily available for transportation charges it will not be required. Documentary evidence is a receipt, paid bill or similar evidence

to support an expenditure. Such evidence will ordinarily be considered adequate to support an expenditure if it shows the amount, date, place and essential character of the expenditure.

### Notes:

(1) No deductions will be allowed for approximations, estimates or unsupported claims.

(2) If a member travels with his family on TAD, only the member's expenses are deductible and it is necessary to allocate an equitable portion of the family's expenses to him. Since the cost of lodging of the family, and transportation unless traveling by automobile, would exceed that for one person, the cost of a single rate for similar accommodations may be deducted.

(3) *Mess Bills Afloat*—The amount paid by a member of the Navy on duty afloat may not be deducted for the period that his ship is away from its home port. A naval officer who is assigned to permanent duty aboard a ship which has regular eating and living facilities, such as an aircraft carrier, battleship, cruiser, destroyer, submarine, or supply ship, has his "home" for traveling expense purposes aboard the ship to which he is assigned.

If claiming change of permanent station expenses, enter excess expenses on line 38 of Form 1040 and attach Form 3903 or a statement of expenses and reimbursements to the return. If claiming IDY, TAD, or reservist expenses, enter excess expenses on line 38 of Form 1040 and attach Form 2106 or a statement of expenses and reimbursements to the return.

## Disability Retired and Disability Severance Pay

(1) Disability severance pay, and retired pay received for temporary or permanent disability retirement under Chapter 61, Title 10, U.S. Code, elected on the basis of percentage of disability may be excluded. If computed on the basis of years of service, or at 57 percent under 37 U.S.C. 115 for service in World War I and II, the portion of disability retired pay which exceeds basic pay multiplied by percentage of disability is not excluded. The net disability retired pay of a retired regular commissioned officer (pay grade O-1 and above), reduced under the Dual Compensation Act by reason of Federal employment, is excludable in the same proportion that his total retired pay is excludable under the foregoing rules. The compensation received during Federal civilian employment is fully includable in gross income. Thus the disability portion of the reduction required under the Dual Compensation Act does not carry-over to the civilian salary, but the regular exclusion may be resumed upon the termination of the civilian employment. A waiver of retired pay in favor of a Veterans Administration pension or compensation, however, applies first to the portion of disability retired pay excluded on the basis of percentage of disability. Such waiver is not retroactive for income tax purposes.

(2) This exclusion from retired pay is computed by the Finance Centers; it is not subject to income tax withholding or included in "wages" reported on Form W-2, and does not terminate at "retirement age." Any excess is subject to withholding of Federal income taxes.

## Sick Pay

(1) *Active Duty Pay*—Active duty pay received for periods of absence from duty by reason of injury or sickness may be excluded from gross income, limited, however, to the lesser of actual pay or a weekly rate of \$100 (\$14.29 per day on the basis of a 7-day week for naval or military personnel). There is a 30-calendar day waiting period before active duty members qualify. The computation is made on Form 2440 and entered on line 37, Form 1040 (Adjustments).

Nontaxable income, such as basic allowances for quarters or subsistence, is not considered in applying this formula. No adjustments for withholding are being made by the defense departments for the "sick pay" exclusion. For this reason it is important that the consultant ask the taxpayer all the questions relevant to sick pay exclusion when the information on the W-2 forms is being transposed onto the taxpayer's income tax return.

(2) *Disability Retired Pay*—"Wages continued" (amount received in excess of that excluded on percentage of disability) because of retirement for personal injuries or sickness resulting from active service in the Armed Forces is excludable as "sick pay" until attainment of retirement age.

If retired directly from active duty (and not on the sick list) the exclusion is limited to a weekly rate of \$75 during the first 30 days of absence, because disability retired pay does not exceed 75 percent of regular pay, and there is a 7-calendar day waiting period unless hospitalized because of this disability at least one day during the period of absence before reaching normal retirement age. After 30 days it is limited to a weekly rate of \$100. If retired while absent from active duty on account of personal injury or sickness for a continuous period of more than 30 days, the 30-day waiting period is charged against the active duty absence, and the retired pay exclusion is immediately allowable up to a maximum weekly rate of \$100.

An extra computation is required if an active duty member is placed on the sick list and retired within 30 days without returning to duty. If the weekly rate of combined active duty and retired "wages continued" exceeds 75 percent of the regular weekly rate of active duty pay for the last four weeks of the month immediately preceding the commencement of the period of absence, there is a 30 day waiting period and thereafter the \$100 per week limitation applies. If 75 percent or less, the exclusion is computed in the same manner as for retirement directly from active duty, as discussed above. No additional sickness or injury need be established and the percentage of disability is immaterial. Retired members are not entitled to the exclusion from retired pay when employed by the same employer. Accordingly, otherwise qualified retired members are not entitled to the "sick pay" exclusion from retired pay when performing services for the United States, whether in the same department or in another department, agency, or branch of the United States Government including nonappropriated fund activities and Government-owned corporations.

## Some Miscellaneous Exclusions

(1) Mustering-out pay may be excluded from gross income.

(2) Uniform gratuity or clothing allowance paid to officers and nurses, and uniforms furnished in kind or by allowance to enlisted members are excludable.

(3) Death gratuity pay (6 months' pay to beneficiary of deceased officer or enlisted member) may be excluded from the beneficiary's gross income.

(4) Amount received and expended by attaches under an allotment for maintenance and official entertaining is excludable.

(5) Allowances received from foreign government by members of military missions to such government for required extraordinary entertainment and living expenses may be excluded.

## Excludable Items From Other Sources

### Life Insurance (Private Companies)

Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income).

If, under an agreement in an insurance contract, an amount is held by the insurer for payment in installments at a date later than death (if death occurred on or after 17 August 1954), the amount held is to be prorated over the period for which payments are to be made, such as a fixed number of years, or years of life expectancy of the beneficiary, and excluded from gross income. The excess of such excluded amounts received each year is to be reported as interest income. However, if interest is paid to a surviving spouse of the decedent, \$1,000 of such interest may be further excluded each year. For this purpose a surviving spouse means the spouse of the insured at date of death, including a spouse legally separated but not absolutely divorced.

### Government Insurance or Indemnity

Amounts paid by reason of death of the insured; dividends, including regular and special, on United States Government and national service life insurance; proceeds from maturing United States Government and national service endowment insurance contracts, and proceeds from surrendered United States Government and national service life insurance policies.

### Commercial Insurance

Dividends represent refund of nondeductible premium payments. Interest earned on such dividends left on deposit is taxable.

### Survivor Benefit Plan (formerly the Retired Serviceman's Family Protection Plan) Annuities

Finance centers furnish full information to survivors on how to report their annuities under the above rule.



## Compensation for Injuries or Sickness

- (1) Amounts received under workmen's compensation acts.
- (2) Amount of damages received whether by suit or agreement.
- (3) Amounts received through accident or health insurance other than amounts attributable to contributions by the employer and not includible in the employee's gross income, or amounts paid by the employer, but see (1) below.
- (4) Amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the Armed Forces of any country.

## Amounts Received Under Accident and Health Plans

- (1) Amounts received as reimbursement for medical care except to the extent a deduction was allowed for medical expenses for any prior year.
- (2) Payments for permanent loss or loss of use of a member or function of the body, or permanent disfigurement of a taxpayer, his spouse, or a dependent.

## Claims by Foreign Claims Settlement Commission

Claims by foreign claims settlement commission, including payments to former prisoners of war.

## Meals and Lodging

The "convenience-of-the-employer" rule is the sole test with respect to meals if such meals are furnished on the business premises of the employer at the place of the employment. The value of lodging furnished in kind by the employer is excluded from gross income if furnished on the business premises of the employer for the convenience of the employer and the employee is required to accept such lodging as a condition of his employment.

## Gifts

The value of property acquired by gift, bequest, devise, or inheritance is excluded, but the income therefrom is not.

## Scholarships and Fellowships

Amounts received for a scholarship or a fellowship grant are excluded from gross income unless they represent: (1) compensation for past, present or future employment services, (2) payment for services which are subject to the direction or supervision of the grantor (giver), or (3) amounts paid to enable the individual to pursue studies or research primarily for the benefit of the grantor (giver). The exclusion is limited, however, if the student or fellow is not a candidate for a degree, to \$300 times the number of months a grant is received in a year, for no more than 36 months in a lifetime, and only if the grant is from a Government or tax-exempt organization.

Appointments to the Armed Forces Academies and under the Navy's educational assistance program for

civilian employees have been held not to constitute scholarships for this purpose.

Military personnel may generally exclude from income amounts provided as a scholarship under the Armed Forces Health Professions Scholarship Program (or a substantially similar, approved program) for the years 1973, 1974, and 1975. This applies whether training is received while on active duty or in an off-duty or inactive status and without regard to whether a period of active duty is required as a condition of receiving the payments.

## Income of Minor Son or Daughter

The earnings of an unemancipated minor son or daughter are the separate income of such son or daughter and not the income of the parent.

## Alimony Income Attributable to Property

"Periodic payments" to a divorced or legally separated wife which are paid out of the income of property assigned or transferred in trust or otherwise in discharge of a legal obligation incurred by a husband under a decree of divorce, separate maintenance or support, or under a written instrument incident to such divorce or separation, shall not be includible in husband's gross income, to the extent they are includible in the gross income of the wife.

## Social Security Benefits

Amounts received from the Federal or State governments under the Federal social security program.

## Veterans Administration Benefits

Veterans Administration benefits (except interest earned on insurance dividends left on deposit) paid to veterans and their families. A full or partial waiver of taxable retired pay already received in favor of nontaxable disability compensation is not retroactive for Federal income tax purposes.

## State Bonus

Payments by a state to veterans for services rendered to the United States.

## Form 1040—Line 14 (Adjustments)

The subjects discussed in this chapter either appear on Form 1040 (e.g., sick pay exclusion, moving expenses or expenses in excess of reimbursement) or are omitted from the return altogether (e.g., B.A.Q., B.A.S. life insurance proceeds, etc.).

All appropriate adjustments to income (with their supporting schedules attached, e.g., Forms 3903, 2106, 2440) are entered on line 14 of Form 1040 and deducted from the income reflected on line 13 to arrive at adjusted gross income (Form 1040, line 15).



## Summary

### Adjusted Gross Income

Consists of wages, plus other income, minus adjustment (exclusions or deductions).

### Excludable or Deductible Items Received From Armed Forces

Combat Pay  
Hostile Fire Pay

The above items are not excludable if in zone on leave, while passing through, or present for personal convenience.

Prisoner of War Exclusion  
Earned Pay Forfeited by Court-Martial

Basic Allowance for Quarters

Basic Allowance for Subsistence

Travel expenses (current records necessary; excess over reimbursements deductible)

Disability, Retired and Disability Severance Pay, Sick Pay

Moving Expenses (reimbursements, includes mileage and per diem, are included in gross income)

(1) Deductible if:

(a) change in residence and duty station, and

(b) the distance between the new duty station and the former residence is at least 50 miles farther than the distance between the former residence and the former duty stations, and

(c) the member remains at least 39 weeks in the general area of the new duty station during the 12 month period following the move.

(2) Deductible expenses include:

(a) meals and lodging while en route.

(b) transportation or hauling.

(c) packing.

(d) crating.

(e) intransit storage.

(f) insurance.

(g) shipping an automobile or pet.

Notes:

(1) All travel must be listed, not just one expensive trip.

(2) Records must be kept.

### Excludable Items From Other Sources

Life Insurance Proceeds From Private Companies  
Government Insurance or Indemnity

Certain Compensation for Injuries or Sickness

Meals and lodging (if satisfies convenience-of-the-employer rule)

Scholarships and Fellowships (subject to dollar limitation, and qualifying conditions)

Social Security Benefits

Veterans Administration Benefits

State Bonus

## Quizzes for Chapter 4

### True-False Quiz

Indicate whether each of the following statements are true or false by inserting "X" in the appropriate box.

1. Benefit payments under the Social Security Act are not subject to tax.

True  False

2. The sick pay exclusion may not exceed a rate of \$100 per week for the first 30 days of illness.

True  False

3. Taxpayer reached retirement age and was retired from the Navy with pay based on length of service. The taxpayer immediately thereafter filed claim with the Veterans Administration for and did receive, disability rating of 20% for phlebitis incurred prior to retirement. Taxpayer is entitled to exclude 20% of his retirement pay from gross income since he could have retired for disability.

True  False

4. On Form 1040 "adjusted gross income" is line 15

True  False

5. The following items are excludable from gross income:

a. Prizes won in a raffle

True  False

b. Disability and death payments

True  False

c. Reimbursement of moving expenses shown on Form W-2

True  False

d. Gambling winnings

True  False

e. Interest on municipal bonds

True  False

f. Child support payments received by wife

True  False

g. Tips

True  False

h. Gifts and inheritances

True  False

i. Clothing allowance

True  False

6. Moving expenses are deductible even if a member uses the standard deduction instead of itemizing his deductions.

True  False

### Multiple Choice Quiz

Directions—Circle the appropriate letter to select the answer to each of the following questions.

1. Gross income includes

A. the value of property acquired by inheritance.

B. the value of property acquired in exchange for services performed.

C. the value of property acquired by gift.

D. the value of services donated to an exempt charitable organization.

E. none of the above.

2. Gross income includes

A. interest on savings account acquired by inheritance.

B. income from property acquired by gift.

C. income from property acquired by bequest.

D. income from property acquired by purchase.

E. all of the above.

3. The sick pay exclusion for a person who receives his regular salary and is absent from work because of injury but not hospitalized starts on the

- A. first day of absence.
  - B. thirty-first day of absence.
  - C. seventh day of absence.
  - D. eighth day of absence.
  - E. thirtieth day of absence.
4. Gross income includes
- A. cash inherited from a decedent parent.
  - B. uniform allowance paid to U.S. Army officer.
  - C. mustering out payment to enlisted man.
  - D. quarters and subsistence furnished to an enlisted man.
  - E. none of the above.
5. Gross income includes
- A. basic family allowance for quarters paid to a serviceman.
  - B. veteran's pension for injuries resulting from active service in the British Army.
  - C. military retirement pay, based on length of service.
  - D. bonuses paid by States to veterans.
  - E. value of automobile received by a disabled veteran.

### Question—Answer Quiz

1. If an enlisted serviceman is hospitalized in the United States as the result of wounds suffered in the combat zone is he entitled to a combat zone

exclusion on any part of his compensation received during such hospitalization? If he was hospitalized, as the result of combat wounds, in the U.S.A. on 15 April would he be entitled to the combat zone extension for filing his income tax return?

2. Cpl. Peter Primrose was involved in an automobile accident. He received \$1,500 from the insurance company as payment for physical damage caused by a whiplash to his neck. Should he include such amount as gross income?
3. How should the following items be treated for income tax purposes?
- a. Reimbursement of \$175 for official travel, the actual cost of which was only \$150.
  - b. Allowance for required official entertainment of \$500, the actual expense of which was \$650, including \$20 for extra maid (cost of maid not ordinary and necessary).
  - c. Reimbursement of \$380 for movement of dependents on official permanent change of station, the actual cost of which was \$275.
4. If the distance between a member's former residence and his former duty station is 21 miles, how many miles must his new duty station be from his former residence to qualify for a moving expense deduction?
5. How long must a member work in his new duty station in order to qualify for a moving expense deduction?

# Chapter 5: Percentage Standard Deduction, Low Income Allowance, Itemized Deductions, and Credits

## Introduction

This chapter discusses deductions allowable from adjusted gross income to arrive at taxable income. The taxpayer may elect to itemize deductions, take the percentage standard deduction, or low income allowance. These deductions are in addition to "deductions for adjusted gross income" discussed earlier. The taxpayer should, of course, elect the type of deduction that gives him the greatest tax benefit. This chapter also discusses certain credits allowed to individuals beginning in 1975.

## Objectives

Participants should be able to explain the following concepts:

(1) The advantages of using the percentage standard deduction, the low income allowance, or itemized deductions.

(2) Those nonbusiness expenses which can be deducted from adjusted gross income to arrive at taxable income, i.e.,

- (a) Medical expenses
- (b) Contributions
- (c) Taxes
- (d) Interest
- (e) Other expenses

Applicable forms for this chapter include:

Form No.

2441 Expenses for Household and Dependent Care Services

## Percentage Standard Deduction

In most cases the amount of the percentage standard deduction depends upon the amount of the taxpayer's adjusted gross income. The percentage standard deduction is allowed instead of itemized deductions and certain credits. The taxpayer should use it when it exceeds the total of his deductions which may be itemized on his return and when it is not advantageous to claim a foreign tax credit. Its use relieves him of substantiating itemized deductions.

An individual who may be claimed as a dependent by another taxpayer, and had unearned income during the year, is subject to a limitation on his standard deduction.

The taxpayer's standard deduction is based only on the amount of "earned income" such as: wages, salaries, fees, or other amounts received as compensation for personal services actually rendered. Dividends, interest, alimony, royalties, and rents do not qualify as earned income but are examples of unearned income.

For further details concerning this limitation see Chapter 1 of Publication 17.

For 1975 tax years the percentage standard deduction on the return of a single individual is 16% of adjusted gross income up to a maximum of \$2,300. On the joint return of husband and wife the maximum amount is \$2,600 or 16% of adjusted gross income, whichever is

less. On the separate returns of a married taxpayer, the percentage standard deduction is limited to \$1,300. As pointed out in Chapter 7 under the section dealing with military personnel married to aliens, a serviceman who is married to a nonresident alien must file a separate return and is limited to a \$1,300 percentage standard deduction. The percentage standard deduction may not be used by one spouse if the other itemizes deductions.

### Illustration—1975

(1) Gross Income (Wages, interest, dividends, etc.)	\$18,000
(2) Sick Pay (Deduction for adjusted gross income)	500
(3) Adjusted Gross Income	\$17,500
(4) Deductions From Adjusted Gross Income:	
Percentage Standard Deduction	2,600
Deduction for Exemptions (2)	1,500
(5) Taxable Income	\$13,400

## Adjusted Gross Income of Less Than \$15,000

In this situation taxpayers whose standard deduction is not limited and who are not itemizing deductions must use the optional tax tables. The tables can be found in the "Instructions for preparing your Federal income tax return for 1975."

## Low Income Allowance

The low income allowance benefits low income taxpayers by removing many of them from the tax rolls. In 1975, this allowance is \$1,600 for single persons, and \$1,900 for married persons filing joint returns (and surviving spouses). For married persons filing separate returns the low income allowance is \$950. The Tax Tables automatically take this allowance into account.

The low income allowance may not exceed the taxpayer's earned income when the taxpayer's dependency exemption is allowable to another taxpayer.

For example, an unmarried full time student who is an eligible dependent of his father has \$600 from wages (earned income) and \$1,800 from dividends (unearned income). The low income allowance of \$1,600 is limited to the earned income of \$600. In this case the Tax Tables cannot be used. The tax must be figured by following the special instructions contained on the tax return.

## Married Person Filing Separate Returns

- If a husband and wife file separate returns, *both* must itemize or *both* must take the standard deduction.
- If they do not itemize, one spouse may not use the low income allowance if the other spouse uses the percentage standard deduction. However, if one spouse uses the standard deduction column the other may use the low income allowance if:

(1) the first spouse's tax is higher under the low income allowance column than under the standard deduction column;

(2) the first spouse's tax is lower under the low income allowance column than under the standard deduction column; and

(3) the combined tax of both spouses is lower than it would be if both used the standard deduction column.

### Married Individuals Living Apart

Married individuals living apart are not subject to the dollar limitations nor the restrictions on the use of the itemized or nonitemized deductions. If they meet the test below, they are not considered married. Therefore they may file as single persons and, if they otherwise qualify, use head of household rates, and may use whatever method of deduction they choose, subject only to the applicable limitations.

To qualify for this exception:

- the spouse must file a separate return *and*
- the spouse must maintain as her (or his) home, a household which, for more than one-half of the entire taxable year, is the principal place of abode of a dependent who is a son, daughter, stepson, or stepdaughter for whom the spouse is entitled to a dependency deduction *and*
- the spouse must furnish more than one-half of the cost of maintaining the household *and*
- the other spouse did not live in taxpayer's home at any time during the tax year.

Both or either spouse may qualify for the special exception under the definition.

### Optional Tax Tables

Optional tables are provided to determine tax liabilities of persons not itemizing deductions, whose gross income is less than \$15,000. The tables for married persons filing joint returns and unmarried persons automatically take into consideration the greater of the percentage standard deduction or low income allowance. For married persons filing separately two tables are provided; one using the percentage standard deduction and the other using the low income allowance.

A married person who files a separate return on Form 1040 or Form 1040A and elects to have his tax computed by the Internal Revenue Service will find that such tax is computed under the percentage standard deduction rather than under the low income allowance, unless he attaches to his return a statement that the tax of his spouse was not determined on the basis of the percentage standard deduction.

A taxpayer with a reduced percentage standard deduction because his dependency exemption is allowable to another taxpayer may not use the optional tables.

### Itemized Deductions

As previously explained, the taxpayer has a choice of itemizing deductions, claiming the percentage standard deduction, or claiming the low income allowance. A taxpayer's decision to itemize deductions depends on whether:

(1) His itemized deductions exceed the percentage standard deduction or the low income allowance,

(2) It is advantageous for him to claim the foreign tax credit, and

(3) He is able to substantiate the deductions claimed. The more common types of allowable deductions are.

Medical and dental expenses  
Charitable contributions  
Education  
Certain investor's expenses  
Interest expense  
State and local taxes  
Alimony  
Household and dependent care expenses  
Tax return preparation fee  
Work clothes  
Casualty losses

### Medical and Dental Expenses—Schedule A, (Form 1040)

If deductions are itemized a taxpayer may deduct medical and dental expenses in accordance with certain limitations. The rules for determining the amount of the medical deduction, the definition of the term "medical expenses," and a list of the more common expense items are set out below.

The expenses of the taxpayer, his spouse, or dependent may be deducted to the extent that the expenses exceed three percent of adjusted gross income. In computing medical expenses, however, drugs and medicines can be taken into account only to the extent that they exceed one percent of adjusted gross income.

In addition, one-half the amount paid for deductible medical insurance will be allowed as a deduction without regard to the three percent limitation. This deduction will be limited to \$150. The other one-half you pay for such insurance, plus the excess over the \$150 limit, will be deductible but subject to the regular three percent rule.

There is no maximum limitation on the medical expense deduction.

### Medical Expenses of Dependent

In computing medical expenses the taxpayer may include amounts paid on behalf of a dependent or a person who could be claimed as a dependent except for the fact that such person had income of \$750 or more or filed a joint return. This status must exist at the time the expenses were paid or incurred.

*Example:* In 1975, Major Fox furnished more than half the support of his son, including medical expenses of \$800. His son, age 22, is not a student and earned \$900. He cannot be claimed as a dependent since he had income of \$750 or more. Nevertheless, in computing medical expenses, the taxpayer may include the \$800 medical expenses paid on behalf of his son.

The taxpayer may deduct the medical expenses paid for an individual for whom the taxpayer meets the support test under a multiple support declaration, even if the taxpayer may not claim the person as a dependent because of the \$750 income test.

Only the medical expenses actually paid by the taxpayer will be included in the deduction. Amounts paid by other parties to the agreement may not be deducted by anyone. But, if the taxpayer actually pays all the person's medical expenses, the taxpayer may include all those in computing deductible medical expenses.

### When Deductible—Reimbursements

Medical expenses are deductible only in the year paid. Thus, prior years' medical expenses paid in the

current year are includible in computing the deduction but advance payments are not. Advance payments are considered to be deposits and may be deducted in the year that such deposits satisfy an actual medical cost.

The total expenses must be reduced by any reimbursement received from insurance or other sources. Amounts received as reimbursement for loss of earnings or damages for personal injuries are not considered as reimbursements for medical expenses. If a taxpayer is allowed a medical expense deduction in one year and is reimbursed in another, the reimbursement must be included in gross income in the year received, to the extent of the deduction claimed.

#### Definition of Medical Expenses

"Medical expenses" is broadly defined. It includes any payment for the diagnosis, cure, treatment, mitigation or prevention of disease, or for the purpose of affecting any bodily function or structure, premiums paid for certain accident or health insurance, and transportation expenses primarily for and essential to medical care.

*Some of the more common deductible items are:*

- (a) Fees paid to physicians, dentists, osteopaths, etc
- (b) Fees paid to practical or registered nurses
- (c) Cost of medicine and drugs
- (d) Fees paid to hospitals for care
- (e) Artificial limbs and teeth, hearing aids
- (f) X-rays, electrocardiograms, blood tests

*The following items are not deductible:*

- (a) Cost of illegal operations
- (b) Cosmetics
- (c) Vitamins for general health not recommended by a physician
- (d) Vacation trips (under most circumstances)
- (e) Toothpaste and brushes
- (f) Maternity clothing; diaper service
- (g) Funeral expenses
- (h) Veterinarian fees

*Notes:* (1) Since almost all the medical and dental treatment of military personnel and their dependents is administered free of charge, a tax deduction for such expenses will be rare except where it involves amounts paid on behalf of a dependent not covered by military facilities. (e.g., parents)

(2) For further information regarding medical and dental expenses see Publication 17.

#### Contributions—Schedule A (Form 1040)

Individuals may deduct contributions they make to qualified organizations—those which have been ruled as qualifying organizations for purposes of the contribution deduction. Generally, an organization knows if it has received a favorable ruling. Some organizations which qualify are:

Official ship, station or post funds used solely for recreation, amusement and welfare of service personnel, United Funds, Chests or Foundations, Churches, Schools and Hospitals (nonprofit), YMCA-YWCA, Police Boys Clubs, Boy and Girl Scouts, DAR, American Legion and Amvets.

#### Nondeductible Contributions

A contribution is deductible only if made without any consideration or benefit coming to the donor. Thus, tuition to a parochial school is not deductible, neither

are dues to a lodge or veterans organization. Gifts to individuals are not deductible. Nor may a deduction be claimed for amounts given to a charitable organization if the taxpayer is permitted to specify that his contribution is to benefit an individual of his choice

Contributions to or for the following are not deductible:

- Pre-adoption expenses
- Civic leagues, social clubs and international organizations
- Communist organizations
- Chambers of Commerce
- Gifts to individuals
- Blood donated to Red Cross or other blood banks

#### Cash or property

Contributions must actually be paid in cash or property before the close of the tax year to be deductible. If the contribution is made in nonappreciated property, the fair market value of the property, not its cost nor its sentimental value, is the controlling factor in determining the amount of the contribution for purposes of the deduction.

Special rules apply to contributions of appreciated property, that is, all property which would give rise to any gain if sold. In certain cases, depending on the type of property, the use which is made of the property, or the identity of the recipient, the taxpayer giving appreciated property must reduce the amount claimed as a deduction. Should you incur this type of contribution, please refer to Chapter 23 in Publication 17 for additional information.

The fair market value of property must be used as the amount of the deduction if the fair market value at the time of the gift is less than its cost (e.g., used clothing). The value of services rendered or the reasonable rental value of property, the use and occupancy of which is donated to a qualified organization, are not deductible contributions. However, amounts, expended for travel expenses (including board and lodging while away from home overnight, gas and oil, but not depreciation) in connection with donated services are allowable contributions, if reimbursements are not received. Also deductible are some "out-of-pocket" expenses which are paid in rendering services to a qualified organization.

*Note:* Instead of a deduction for actual expenses for gas, oil, etc. of an automobile, taxpayers may deduct a standard mileage rate of 7¢ per mile plus parking fees and tolls as a contribution. Depreciation, insurance, and repairs are not deductible.

#### Time for Deduction

The deduction is allowable only for the tax year in which the contribution is actually paid. Thus, a pledge of a contribution, even though it might be enforceable, does not give rise to a deduction.

#### Limitation on the Deduction

In general, the taxpayer's charitable contributions cannot exceed 50% of adjusted gross income for the year (computed without regard to net operating loss carryback). Contributions to most charities may be deducted up to 50% of adjusted gross income. However, contributions to certain nonoperating foundations,



veterans' organizations, fraternal societies and cemetery organizations, and contributions for the use of any charitable organization, are limited to 20% of adjusted gross income. Also, there is a 30% of adjusted gross income limitation that applies only to contributions of certain capital-gain property.

Refer to Chapter 23 of Publication 17 for additional information concerning these limitations.

#### Carryover

If the taxpayer's contributions to organizations which are subject to the 50% deductibility limit (or 30% limit for capital gain property) exceed that limit in the year paid, then such excess may be deducted in subsequent years. The amount in excess of 50% (or 30%) of his adjusted gross income may be treated as a charitable contribution in each of the five succeeding years in order of time (until it is used up) but not beyond that time. The 50% (or 30%) limitation on deduction for charitable contributions remains in effect with respect to the five succeeding years.

Contributions which may be carried over are only those made to the organizations for which deduction may be taken in an amount of up to 50% (or 30%) of the taxpayer's adjusted gross income. Therefore, it does not include contributions to private foundations to which the 20% limit applies.

Chapter 23 in Publication 17 contains additional information concerning contributions.

#### Taxes—Schedule A (Form 1040)

Generally, taxes for which a taxpayer is legally liable are deductible only in the year paid. Those which may be taken as deductions are certain foreign income taxes (except when foreign tax credit is claimed) and foreign real property taxes and the following State, municipal, and county taxes:

- (1) real property
- (2) personal property
- (3) income
- (4) general sales (see tables in Federal Income Tax Forms)

*Note:* When using the Sales Tax Tables to determine the amount of sales tax deductible on Schedule A (Form 1040), add to the amount shown on line 15, Form 1040 (adjusted gross income), nontaxable items which increase spendable income such as social security, railroad retirement benefits, sick pay exclusion, untaxed portion of long-term capital gains, etc. This may increase the sales tax deduction.

- (5) gasoline (see tables in Federal Income Tax Forms)

*Taxes which may not be taken as a deduction are:*

- (1) cigarettes, tobacco and liquor
- (2) auto registration and inspection fees
- (3) drivers' licenses, except if they qualify as personal property tax
- (4) poll taxes
- (5) admission taxes
- (6) Federal taxes
- (7) Social security taxes

- (8) State inheritance, estate, legacy and gift taxes
- (9) Foreign personal property, general sales, or gasoline taxes.

#### Real Estate Taxes

These taxes can be deducted only by the owner of the real estate upon which the tax is imposed. If the purchase of real property involves the assumption of back taxes the payment of such taxes is not deductible. When real property is sold the deduction for real estate taxes must be apportioned between the buyer and seller according to the number of days in the real property tax year that each held the property. Real estate taxes paid in escrow are not deductible until paid out of the escrow account to the taxing agency.

#### Taxes Paid for Another

Since, normally, taxes are deductible only by the person upon whom they are imposed, taxes paid for another are not deductible. Thus, for instance, a husband filing a separate return may not deduct taxes paid on his wife's property or the payment of her state income taxes. Of course, these taxes could be deducted on a joint return.

#### When Deductible

Generally, taxes are only deductible in the year they are paid. Thus, amounts withheld from a taxpayer's salary for state income taxes are only deductible in the year they are withheld.

#### Nondeductible Taxes

*Regulatory Taxes*, such as marriage licenses, hunting licenses and dog tags are not deductible. Service charges, such as water and sewer bills, are also nondeductible.

*Assessment for Local Benefits* which tend to increase the value of a taxpayer's property, such as assessments for the construction of water and sewage systems, are not deductible.

*Note:* Chapter 22 in Publication 17 deals further with the subject of taxes.

#### Interest Expense—Schedule A (Form 1040)

Generally, all interest paid by a cash basis taxpayer on debts for which he is legally liable is deductible. The debt must: (1) result from an actual debtor-creditor relationship in which repayment of the loan is intended, and, (2) be based on a valid obligation to pay a fixed or determinable sum of money.

Thus, a deduction is not allowed for interest payments made by a taxpayer on behalf of another person if the taxpayer has no legal obligation to make the payments.

*Example:* A taxpayer lives in a home owned by his mother, whom he supports. He makes the payments on her mortgage. He cannot claim an interest expense deduction since he has no legal obligation to make such payments.

Interest payments on personal loans, home mortgages (including prepayment penalties) and installment purchase contracts are the more common types of interest deductions. The amount of interest is usually separately

stated on personal loans and home mortgages and they do not present a problem of computation. However, discounted notes and installment buying may require special computation.

#### Forfeited Interest Deduction

For tax years beginning after 1972, individuals may deduct from gross income the amount of interest forfeited on premature withdrawal of funds from a time-savings account.

Form 1099-INT usually indicates the "total" interest payable on the time-savings account. Any interest forfeited and not received is deductible from gross income. Enter the loss on line 41 of Form 1040.

#### Note Discount

When money is borrowed, the note sometimes is for more than the amount received. That is, the interest is subtracted from the face amount of the note and the borrower receives the balance. A cash basis taxpayer, in such a case, can only deduct the interest as the payments on the note are made. Part of each payment represents interest and is deductible in the year paid.

*Example:* Taxpayer signs a note for \$1,200 on 30 March, payable in twelve equal monthly installments beginning 30 April. The note is discounted and he receives only \$1,128. The discount of \$72 is considered paid in twelve equal installments of \$6. Thus, for the first year the deduction is \$54, or nine payments of \$6 each.

#### Mortgage Interest and Service Charges

Only the portion of the mortgage payment attributable to interest is deductible as such. The term "points" is sometimes used to describe the charges paid by the borrower to the lender as loan origination fees, maximum loan charges, or premium charges. If these charges are paid solely for the use or forbearance of money, they are deductible as interest. If the payment of these charges is compensation for specific services that the lender performs (such as the lender's appraisal fee, the cost of preparing the mortgage note or deed of trust, settlement fees or notary fees, etc.) then it is not interest.

The amount of "loan origination fees" charged by the lender in addition to the maximum rate of interest permitted to be imposed upon VA insured loans is not interest. "Points" which are actually loan placement fees that the seller may be required to pay the lender as a condition to arranging financing terms for the buyer are not deductible as interest. Prepayment penalties required to be paid to the holder of a mortgage for the privilege of prepaying the mortgage are deductible as interest.

For more information on mortgage interest refer to Publication 17.

A charge levied by a retail store on its "revolving charge account" customers only in the event the full balance of the account is not paid within 30 days is deductible as interest if the charge is (1) not a fixed fee but is based on the customer's unpaid balance (2) computed monthly, and (3) solely for the privilege of deferring payment.

#### Installment Payments

If personal property, such as an automobile, radio, television set, etc., is purchased on the installment plan in which the carrying charge or finance charges are separately stated, but the interest charge cannot be ascertained, a portion of the payments may be treated as interest.

The amount of the carrying charge that may be deducted as interest is the lesser of: (a) an amount which represents six percent of the average unpaid balance, or (b) the portion of the total fee or service charge allocable to the year. Because of this limitation, two computations are necessary:

*First*—Divide the total stated carrying charge by the number of months in the contract. This gives the monthly carrying charge. Then multiply this monthly carrying charge by the number of months the contract was in existence in the taxable year. This gives the total carrying charge that may be allowed for that year.

*Second*—The average unpaid balance is determined by adding together the amount of the unpaid balance at the beginning of each month of the year, during which the contract was in existence. This total must be divided by twelve to get the "average unpaid balance," regardless of the number of months the contract was in existence. Compute six percent of this "average unpaid balance."

The amount of the deduction is the lesser of the amounts determined above.

*Example:* On 22 June, taxpayer purchased a home freezer for \$254 plus a carrying charge of \$20. He made a down payment of \$50 and agreed to make sixteen monthly payments of \$14 each, on the twenty-second of each month, beginning 22 July. The portion of the carrying charge deductible as interest is computed as follows:

(1) Carrying charge .....	\$ 20.00	
Carrying charge per installment (\$20.00 divided by 16 installments) .....	1.25	
Multiply by number of installments paid in the return year .....	×	6
Carrying charge allocable to return year .....		\$7.50
(2) Unpaid balance (including carrying charge) outstanding:		
July 1 (\$254 + 20 - \$50) .....	224.00	
August 1 .....	210.00	
September 1 .....	196.00	
October 1 .....	182.00	
November 1 .....	168.00	
December 1 .....	154.00	
Total monthly unpaid balance .....	\$1,134.00	
Average unpaid balance (\$1,134 divided by 12) .....	94.50	
6% of \$94.50 .....		\$5.67
(3) Interest deduction allowable (Lesser of computation under (1) or (2)) ..		\$5.67

A deduction may be taken for interest paid on tax deficiencies, but any amount which is designated as a penalty is not deductible. No interest is deductible if borrowed money is used to purchase or carry tax-exempt securities.

#### Paid In Advance

A taxpayer using the cash method of accounting who pays interest in advance for a period extending more

than 12 months beyond the end of his current tax year must deduct this amount ratably over the tax years involved. Interest paid in advance for a period not in excess of 12 months following the end of his current tax year may be deducted by a cash method taxpayer in the year paid, if the deduction does not give rise to a material distortion of income.

### Losses—Schedule A (Form 1040)

#### Losses—Deductible

(1) Losses to taxpayer's property used for personal purposes sustained as a result of fire, storm, shipwreck, sonic boom, or other casualty, or from theft, are deductible to the extent they exceed \$100 for each casualty or theft. Such losses must be further reduced by the insurance or other compensation the taxpayer receives or expects to receive.

Progressive deterioration of property through a steadily operating cause is not considered a casualty. Termite damage to a residence normally occurs over a prolonged period of time and is not considered a casualty. Nor is it a casualty when an individual loses an article through carelessness or negligence. Further, the deduction is limited to the taxpayer's property. Damages paid by the taxpayer for injury to someone else's property are not deductible unless the injuries arose out of the taxpayer's business.

Loss arising from theft or embezzlement is considered sustained during the taxable year in which the loss is discovered by the taxpayer.

The amount of loss to be deducted is the lesser of (1) the decrease in the fair market value of the property as a result of the casualty, or (2) the taxpayer's adjusted basis in the property. This amount must be reduced by insurance or compensation received or expected.

*Example:* Capt. Black had purchased a parcel of land in prior years for \$1,000 and had erected his residence thereon at a cost of \$7,000. Subsequent improvements to the property were made at a total cost of \$2,000. Immediately before a storm, the land and house had a fair market value of \$18,000. The storm completely destroyed the house, leaving no salvageable residue. The land, despite some storm damage, had a fair market value immediately after the storm of \$2,000. The amount recovered through insurance was \$7,000. The taxpayer has a deductible casualty loss of \$2,900, computed as follows:

#### Step (1):

Fair market value of property immediately before casualty .....	\$18,000
Fair market value of property immediately after casualty .....	2,000
Decrease in fair market value .....	\$16,000
Insurance recovery .....	7,000
Difference .....	<u>\$ 9,000</u>

#### Step (2):

Adjusted basis of property:	
Cost of land .....	\$ 1,000
Cost of house .....	7,000
Cost of improvement .....	2,000
Adjusted basis of property .....	\$10,000
Insurance recovery .....	7,000
Difference .....	<u>\$3,000</u>

The deductible loss is limited to the lesser of the differences obtained in Step (1) or (2), minus the \$100 reduction, or \$2,900.

(2) A loss occasioned by damage to taxpayer's automobile maintained for pleasure is deductible to the extent it exceeds \$100 and is not covered by insurance, unless it is the result of a willful act or the willful negligence of the taxpayer. If damage to his automobile results from the faulty driving of the operator of an automobile with which the automobile of the taxpayer collides, the loss occasioned to the taxpayer by such damage is likewise deductible. The loss must be caused by an identifiable event of a sudden, unexpected, or unusual nature, not deterioration.

*Example:* An automobile not used for business was involved in an accident. The original cost of the automobile was \$2,800. Its fair market value immediately before the accident was \$1,400. After the accident, the only value was salvage value of \$150. The amount recovered through insurance was \$750. Taxpayer had deductible casualty loss of \$400, computed as follows:

Fair market value of auto immediately before casualty .....	\$1,400
Fair market value of auto immediately after casualty .....	150
Difference, but not in excess of cost or adjusted basis .....	\$1,250
Insurance recovery .....	750
Total loss .....	\$ 500
Less: \$100 reduction .....	100
Deductible loss .....	<u>\$ 400</u>

(3) If a taxpayer sustains a loss from a disaster, and the disaster occurred in an area later determined by the President of the United States to warrant assistance by the Federal Government under the Disaster Relief Act of 1970, he may elect to deduct that loss on his return for the tax year immediately preceding the taxable year in which the casualty occurred. If he makes the election, the loss will be considered as having occurred in the preceding year. See Chapter 37 in Publication 17 for procedures for making the election.

(4) Wagering losses to the extent of wagering gains.

#### Losses—Not Deductible

(1) Damage to household furniture or furnishings in transit or storage unless occasioned by fire, storm, shipwreck, theft, or other casualty.

(2) Fines and penalties imposed by courts-martial and civil courts.

(3) Accidental losses of property, such as a ring from a finger.

(4) Unrealized depreciation in the market value of stocks and securities.

(5) Wagering losses in excess of gains.

(6) No deduction is allowable for loss resulting from sales or exchanges of property—

(a) Either directly or indirectly between members of a family, which includes the taxpayer's spouse, brothers and sisters (whether by the whole or half blood), ancestors, and lineal descendants.

(b) Except for distribution in liquidation, between an individual and a corporation in which the taxpayer, owns individually or in conjunction with members of his family, owns more than 50 percent in value of the outstanding stock.

(c) If within 30 days before or after the sale or exchange of stock or securities, the seller acquires by purchase or taxable exchange, or contracts to acquire substantially identical stock or securities.

(d) Used as the taxpayer's personal residence up to the time of sale.

(7) Losses from death to trees as a result of disease or attack by insects.

(8) Amounts paid by taxpayer for damages to another's property.

Refer to Publication 17 for information on how to report these losses.

### Miscellaneous Deductions—Schedule A (Form 1040)

The remainder of this chapter will be devoted to those itemized deductions which, if deductible, should be entered in the last category of itemized deductions on Schedule A (Form 1040), (i.e., miscellaneous deductions), and to miscellaneous items which are not deductible.

#### Expenses for Child and Dependent Care Services

The amount paid by a taxpayer for these employment-related expenses are deductible if he furnishes over half the cost of maintaining a home which is the taxpayer's principal residence as well as the principal residence of one or more of the following individuals:

(1) A dependent of the taxpayer under the age of 15 for whom the taxpayer is entitled to claim a dependency exemption.

(2) A dependent of the taxpayer (or a person who could be claimed as a dependent, if it were not for the gross income test) regardless of age who is physically or mentally incapable of self-care, or

(3) The taxpayer's spouse if physically or mentally incapable of self-care.

If the taxpayer is married, over half of the cost of maintaining the household must be supplied by the taxpayer and spouse, and the taxpayer and spouse must live together.

#### Limitations on Deductible Amounts

The deduction is limited to the amount incurred during any month, but it may not exceed \$400 per month when the expenses are incurred in the taxpayer's household. When incurred outside the taxpayer's household for the care of a dependent under 15, the expenses are deductible only to the extent they do not exceed in any one month the following amounts:

(1) \$200 for one child,

(2) \$300 for two children,

(3) \$400 for three or more children.

Expenses incurred outside the taxpayer's household on behalf of a disabled dependent (unless under 15) or a disabled spouse are not deductible as household or dependent care expenses. However, such expenses may qualify as medical expenses.

When the taxpayer's adjusted gross income exceeds \$18,000 for the year, the amount of the deductible expenses incurred during any month must be reduced by that portion of one-half of the excess of the adjusted gross income over \$18,000 which is properly allocable

to that month. In the case of a married couple, the combined adjusted gross income of the husband and wife on their joint return is taken into account for this purpose. The adjusted gross income limit has been raised to \$35,000 for calendar year taxpayers beginning in 1975.

#### Reduction of Expenses by Certain Payments

If the expenses are incurred during the year for a disabled dependent, they are reduced by the amount that the sum of (1) his adjusted gross income for the year and (2) the nontaxable payments he receives (except gifts) because of his physical or mental condition exceeds \$750.

*Example:* The taxpayer, a widow, incurred employment-related expenses of \$200 per month for 1975 on behalf of a disabled son. The son had an adjusted gross income of \$500 for 1975 and received \$1,152 (\$96 per month) for 1975 from the Veterans Administration as disability compensation. Since \$1,652 (\$500 plus \$1,152) exceeds \$750 by \$902, the taxpayer may deduct only \$1,498 (\$2,400 less \$902) as employment-related expenses on her 1975 return.

If the expenses are incurred for a physically or mentally incapacitated spouse, they are reduced only by the nontaxable disability payments (except gifts) received by the disabled spouse.

The amount of the deductible employment-related expenses is reduced by these payments before the over \$18,000 (\$35,000 for 1976) adjustment discussed above is made.

#### Married Couples

If the taxpayer is married at the close of the taxable year, the deduction is allowed only if the taxpayer files a joint return with his spouse, and the deduction applies only during any month in that part of the year when both spouses are gainfully employed on a substantially fulltime basis (unless one spouse is physically or mentally incapable of self-care).

If the taxpayer is married but is living apart from his spouse, he is considered as unmarried for purposes of this deduction if he meets the test explained at the beginning of this chapter under "Married Individuals Living Apart".

#### Payments to Related Individuals

No deduction is allowed for payments made for employment-related expenses if the payments are made to a related individual or a dependent household member. A related individual for this purpose includes the taxpayer's child, stepchild, grandchild, brother, sister, stepbrother, stepsister, parent, ancestor of either parent, stepparent, niece, nephew, aunt, uncle, in-laws and an individual (other than taxpayer's spouse) who is a member of the taxpayer's household and lives with him for the entire year and is his dependent.

Form 2441 is used to figure the deductible expenses for child and dependent care services. Chapter 25 in Publication 17 treats this subject in depth.

#### Uniforms

It is the position of the Service that the cost and maintenance of uniforms are allowable deductions if.



(1) the uniforms are specifically required as a condition of employment, and (2) are not of a type adaptable to general or *continued* usage to the extent that they take the place of ordinary clothing. In order to determine whether both of the required tests have been met, consideration must be given to the particular facts in each case, and the occupation of the taxpayer is not necessarily controlling. The fact that a uniform might be required as a condition of employment is not, of itself, sufficient to warrant the allowance of the deduction. For example, military apparel is specifically required to be worn by members of the uniformed services. However, such apparel is adaptable generally to continued wear to the extent that it replaces regular clothing; consequently, no deduction is allowable for the cost and maintenance of such a uniform.

*Note.* The deduction of the cost and maintenance of uniforms of a distinctive type does not extend to ordinary work clothing, the cost and maintenance of which is a nondeductible personal expense.

**(1) Army Officers' Equipment**

The cost of equipment, to the extent only that it is especially required by this profession and does not take the place of articles required by civilian life, such as corps devices, Sam Browne belts, epaulets, campaign bars, aiguillettes and swords, are deductible.

**(2) Naval Officers' Equipment**

The cost of gold lace, cap devices, and insignia of rank, which are additions to the uniform and are required by his profession, are deductible.

**(3) Reservists of the Armed Forces**

Reservists of the Armed Forces may deduct the cost and maintenance of uniforms which may be worn on active duty for training or for temporary periods when attending service school courses or training assemblies. However, such costs must be reduced by the reimbursement received.

**Fatigues**

Amounts expended by members of the armed services of the United States on active duty for the purchase and maintenance of required military fatigue uniforms, where local military regulations prohibit their off-duty wear, are, to the extent the expenses exceed allowances received therefor, deductible for Federal income tax purposes as ordinary and necessary business expenses provided such taxpayers itemize their deduction.

**Alimony Payments**

Generally alimony payments are deductible by the husband and are includible as taxable income by the wife. Such payments cannot be counted by the husband in determining how much support he pays for his children to establish them as dependents. In fact, unless payments are specifically designated by the terms of the decree, instrument or agreement as support of a minor child, such payments constitute alimony, deductible by the husband and includible by the wife. If payments are made for both child support and alimony, and the husband pays only a portion of such payment, the amount designated as child support will be considered first and

the excess, if any, alimony. For tax purposes a minor child is anyone who has not attained the age of 21 regardless of what state law says.

*What are alimony payments?*

The deduction is limited to amounts qualifying as periodic payments.

(1) Required under the terms of the decree of divorce or separation, or a written instrument incident to such decree, made in discharge of a legal obligation based on the marital relationship, and paid after the decree.

(2) Made under a written separation agreement entered into after 8/16/54, made after the agreement was executed, and the husband and wife live apart and file separate returns.

(3) Made under a decree for support or any type of court order entered after 3/1/54 because of the marital relationship; and husband and wife live apart and file separate returns.

*What are periodic payments?*

Periodic payments are payments to be made over an indefinite period of time. This is the normal situation. *Installment payments on a lump sum settlement do not qualify as periodic payments and as such are not deductible as alimony unless:*

(1) They cover a period of 10 years or less and are subject to termination because of contingencies (e.g., death of either spouse, remarriage of the wife or change in economic status of either spouse.)

(2) They cover a period over 10 years. In this case they are periodic payments and deductible but only to the extent that the sum of the payments received during the spouse's taxable year do not exceed 10% of the amount specified. Payments made for back years in the current year are deductible when paid by the husband and includible by the wife regardless of the 10% limitation. However, advance alimony payments are subject to the 10% limitation and could result in an excess of 10% of the principal sum being nondeductible by the husband and nontaxable to the wife.

*Example:* A divorce decree granted in 1973 obligated a husband to pay his wife \$120,000 in installments of \$10,000 for 12 years. Husband paid \$10,000 in 1973, no payments in 1974, and \$30,000 in 1975 (\$10,000 back alimony, \$10,000 current and advanced 1976 alimony).

1973	\$10,000	deductible by the husband	includible by wife
1975	\$22,000	.....	..... [\$10,000 back plus \$12,000 (10% limit)]

**Allotments**

A serviceman, under a decree for support, may authorize a monthly allotment for his wife, from whom he is separated. The allotment includes a tax-exempt quarters allowance to which he is entitled, plus an amount withheld from his pay. He may deduct, and his wife must include in her income, only the amount withheld from his pay.

*Lump sum settlements*

Payments of a lump sum or installments not qualifying as periodic payments are not deductible by the husband or includible by the wife. They may represent





property settlements. A transfer of property (e.g., house) owned by the husband to a wife for the purpose of extinguishing her inchoate dower rights in discharge of a property settlement must be treated as a taxable event.

*Example:*

FMV of house .....	\$30,000
Basis .....	20,000
Capital gain .....	<u>\$10,000</u>

The wife, who receives property in exchange for her marital rights, realizes neither gain nor loss, since the rights she relinquished are taken to be equal in value to the property.

In a community property state no gain or loss is to be reported because this is merely an equal division of community property.

*Alimony trusts and other indirect payments*

Periodic payments attributable to property held in trust, to life insurance, endowment or annuity contracts, although taxable to the wife just as though she had received cash directly from her husband, are not deductible by the husband. Instead, the husband would have an exclusion as to the trust income which would otherwise be taxable to him.

*Alimony is reported by wife*

Alimony payments by cash or through commercial annuity contract or endowment or life insurance policy are reported on Form 1040, Part I, Line 34 as income.

Income from an alimony trust is reported on Schedule E (Form 1040) Part III as income from a trust.

**Contribution to Candidate for Public Office**

A taxpayer is allowed a deduction for the amount of political contributions made after 1971 and before January 1, 1975 up to a maximum of \$50 for a single person or a married person filing a separate return. The deduction may not exceed \$100 on a joint return.

Alternatively, the taxpayer may claim a credit against tax for his political contributions instead of claiming them as an itemized deduction. The amount of the credit is one-half of the amount of the political contributions made with a maximum credit of \$25 on a joint return and \$12.50 on a separate return of a married person or a single person.

For political contributions made after December 31, 1974, in taxable years beginning after that date the amount of allowable deduction or credit has been increased. Thus, for 1975, the amount of allowable deductions will be \$100 for a single person and married persons filing separate returns, and will be \$200 for taxpayers filing joint returns.

The maximum credit for 1975 is \$50 on a joint return and \$25 for single persons and married persons filing separate returns.

A political contribution for purposes of the deduction or credit is a contribution or gift of money to:

(1) An individual, who has publicly announced that he is a candidate for nomination or election to any Federal, State, or local elective public office in any primary, general, or special election, for his use in seeking office,

(2) Any committee, association, or organization organized and operated exclusively for the purpose of supporting a candidate seeking elective public office for its use in furthering this purpose,

(3) The national committee of a national political party, or

(4) The State or local committee of a national political party as designated by the national or State committee of the party.

An amount paid for a ticket in a lottery, raffle, drawing, etc., for valuable prizes, organized for the purpose of raising funds in a candidate's campaign is not considered a contribution or gift and therefore is not eligible for the deduction. However, the cost of a ticket to a political dinner or fund raising function for a political candidate, where the event is essentially political, i.e., primarily devoted to political speeches or discussions, is a deductible political contribution.

**Expenses for Education**

A taxpayer may deduct educational expenditures as ordinary and necessary business expenses if the education either:

(1) maintains or improves skills required by the individual in his present employment or trade or business, or

(2) meets express requirements set by the individual's employer or by law, which are a condition of the employee's retaining an established employment status or rate of compensation.

However, even if one or both of the above requirements is met, expenses are not deductible if the education either:

(1) is required so that the taxpayer can meet the minimum educational requirements for qualification in his present employment or trade or business, or

(2) qualifies the taxpayer for a new trade or business.

Self-employed persons may ordinarily deduct expenses for education if it is customary for other established members in the trade or business to undertake such education to maintain or improve skills required in their trade or business. Employees may deduct such expenses if incurred primarily for a bona fide business purpose of their employer and not primarily for their own benefit. Employees' expenses for educational activities may be deductible even though such expenses are incurred voluntarily and even though the courses carry academic credit or eventually result in an increase in salary or in a promotion.

Amounts spent for tuition, laboratory fees, books, and similar items are examples of expenses incurred for educational purposes. If the educational activities otherwise qualify, then the cost of local transportation (but not commuting expenses) and the cost of travel, meals, and lodging while away from home overnight is also deductible.

For self-employed and for individuals employed as outside salesmen, educational expenses, the cost of travel, meals and lodging while away from home, and local transportation expenses incurred in the pursuit of such educational activities are deductible in arriving at adjusted gross income.

Employees, other than outside salesmen, may deduct expenses for education only in arriving at taxable in-

come if the standard deduction is not elected (i.e., as itemized deductions). But travel, meals and lodging away from home overnight and local transportation expenses incurred in the pursuit of the educational activities are deductible in arriving at adjusted gross income whether or not the standard deduction is elected. Reimbursed education expenses are reported in a statement attached to the income tax return; the amount of expenses in excess of reimbursements is deductible from adjusted gross income in arriving at taxable income.

The deductible educational expenses of a veteran of the Armed Forces are not required to be reduced by tax-exempt educational benefits received from the Veterans Administration.

The qualifying requirements outlined above were applied in *disallowing* the following:

(1) Nondeductible education expenses.—If the primary purpose for which they are incurred is to:

(a) Obtain a new position.

(b) Fulfill the general educational aspirations of the taxpayer.

(c) Meet the minimum requirements for qualification or establishment in an intended trade or business, profession, or specialty therein, then such educational expenses are not deductible.

(2) Nondeductible travel expenses incurred in the pursuit of educational activities:

(a) Commuting from home to the place of education on a nonworking day.

(b) In general, a taxpayer's expenditures for travel as a form of education are deductible to the extent a major portion of the travel activity during the period of travel directly maintains or improves the skills required in the taxpayer's employment, trade, or business.

(c) If the taxpayer engages in some personal activities such as sightseeing, social visiting or entertaining, then the expenses attributable to such personal activities are not deductible.

(d) If the taxpayer's travel away from home is primarily personal, expenses for travel, meals and lodging (other than meals and lodging incurred during the time spent in participating in deductible educational pursuits) are not deductible.

(e) Costs of meals and lodging in the pursuit of educational activities not involving away from home travel is not deductible.

### Brokerage Fees

Brokerage fees which the taxpayer pays to a broker, a bank, or similar agent to collect his taxable bond interest or dividends on shares of stock are deductible on Schedule A (Form 1040). A fee which he pays to a broker to acquire investment property, such as stocks or bonds, is not deductible, but is added to the cost of the property. A fee paid in connection with the sale of property is a selling expense and may only be used to determine gain or loss from the sale. A fee paid to purchase "nontaxables" (e.g., State bonds) is nondeductible.

### Safe Deposit Box Rent

Safe deposit box rent is deductible if the box is used for the storage of stocks, bonds, etc., the income from which is taxable. The rent is not deductible if the box is used to store personal effects or tax-exempt securities.

### Employment Agency Fees

Expenses incurred in seeking new employment in the same trade or business are deductible even though new employment is not obtained.

### Miscellaneous Items—Not Deductible

The following items are not deductible from adjusted gross income:

(a) Personal, living, or family expenses, other than outlined above.

(b) Living expenses of personnel stationed in one locality or overseas for an indefinite period.

(c) The cost of daily transportation between home and office.

(d) Tax penalties.

(e) Traffic fines.

(f) Ordinary repairs, alterations, and depreciation on a building occupied as a personal residence by the owner or his family.

(g) Any amount paid out for new buildings, or for permanent improvements made to increase the value of any property or estate. These are capital costs.

(h) Premiums paid on any life insurance policy.

(i) Expenses of visiting home while on furlough, leave, or liberty.

(j) Amounts paid for the purchase of United States savings bonds.

(k) Mortgage of other insurance premiums on a personal residence.

(l) Expenses of education of a spouse or dependent.

(m) Club dues and initiation fees.

(n) Certain expenses of a hobby in excess of hobby income.

(o) Uniforms for active duty personnel midshipmen, and cadets.

(p) Legal fees not connected with production or collection of income, management of property held for production of income, or incurred in connection with the determination, collection or refund of any tax.

*For Example:* Amounts paid as a result of suits brought against the taxpayer for alienation of affection, breach of promise to marry, slander, defamation of character, attorney's fees paid in a suit for divorce or separate maintenance, or amounts paid to prevent the filing of such suits are personal legal expenses and are not deductible.

(q) Attorney's fees for the preparation of a will.

(r) Bar examination fees.

### Notes:

(1) Subschedules should be used if there is not enough space on the return to list the particular itemized deductions. The total amount shown on such sub-schedule should be inserted in its appropriate place on Schedule A (Form 1040) and the comment "see schedule # . . . attached" written across the schedule.

(2) Having acquired all this knowledge about itemized deductions, the consultant is now faced with a practical problem. To prepare all the schedules of itemized deductions is time consuming, and, after such effort has been made, to learn that the taxpayer would benefit more by taking the percentage standard deduction or the low income allowance than by itemizing his deductions can be downright harassing. The following ques-

tions to a military taxpayer will, generally, answer this problem.

(a) Does the taxpayer own a personal residence in the United States? If he does, then the taxes and mortgage interest on such property warrant itemizing deductions.

(b) Does the taxpayer make alimony payments to an ex-spouse?

(c) Do the taxpayers pay household and dependent care expenses so that they may be gainfully employed?

(d) Did the taxpayer have a large casualty loss during the taxable year?

(e) Did the taxpayer pay any large medical bills, not covered by insurance for a parent?

If the answer to all of these questions is negative, then the probability will be that the taxpayer should not itemize his deductions.

## Credits

### Credit for Personal Exemptions

For 1975, an individual taxpayer is allowed a credit against tax liability in the amount of \$30 for each dependent the taxpayer is entitled to claim as a personal exemption (other than those for age and blindness).

The total credit cannot exceed the total tax liability for the year. Furthermore, the tax liability is reduced by the credit for personal exemptions before reduction by the following credits:

- (1) the foreign tax credit,
- (2) the retirement income credit,
- (3) the investment tax credit,
- (4) the work incentive program credit, and
- (5) the credit for contributions to political organizations.

### Credit for Certain Earned Income

For 1975, an individual who meets certain requirements may be entitled to a tax credit based on the individual's earned income. To be eligible, the individual must:

(1) maintain a household which is the principal place of abode of that individual and also the principal place of abode of a child for whom the taxpayer is entitled to claim a dependency exemption.

(2) not be entitled to exclude any amount of income from foreign sources (or from U.S. possessions).

(3) must have "earned income."

If these three tests are met, a taxpayer will be entitled to a tax credit of up to \$400. This amount is computed by taking 10% of the taxpayer's earned income (up to \$4,000). However, the \$400 credit must be reduced by 10% of the amount of the taxpayer's adjusted gross income (or earned income if greater) that exceeds \$4,000.

Earned income for this purpose means wages and other employee compensation as well as net earnings from self-employment. These amounts are taken into consideration only if the individual must include them in gross income. Also, the earned income is taken into account without regard to community property laws.

No amount received as a pension or annuity is included in earned income.

The credit can be claimed by married individuals only if they file a joint return. The credit is also allowed only with respect to a full taxable year.

In addition, the earned income credit is allowed in excess of tax liability. Any amount of the credit in excess of tax liability will be the equivalent of an overpayment of tax and will be refundable to the taxpayer (a form of negative income tax).

For example, if Pvt. Jones has income from wages of \$3,900 and interest income of \$150 and meets the other requirements discussed above, his earned income credit will be \$390. The interest income is not included in the computation since it is not earned income. If Pvt. Jones had a tax liability of \$250, he would receive a refund of the difference of \$140 (\$390 minus \$250).

On the other hand, if Sgt. Smith received \$6,500 of earned income, the maximum credit of \$400 (10% x \$4,000) would be reduced by 10% of the excess of the earned income over \$4,000. In this case it would be reduced by \$250 (10% x \$6,500 minus \$4,000). Sgt. Smith's total earned income credit would be \$150 (\$400 minus \$250).

### Credit for Purchase of New Housing

An individual is allowed a credit against his income tax liability equal to 5% of the purchase price of a new principal residence purchased (or constructed) by the individual. The credit is allowed for only one residence and is limited to the tax liability for the year up to \$2,000 (or \$1,000 for married taxpayers filing separate returns). If the residence is purchased by more than one individual (other than husband and wife) the credit may be allocated among them but may not exceed \$2,000.

A "new principal residence" means a principal residence the original use of which began with the taxpayer.

The term includes single family structures, a residential unit in a condominium or cooperative housing project, the taxpayer's unit in a duplex or row house, and mobile homes. Renovated buildings (regardless of the extent of renovation) do not qualify for the credit. Original use means the property has never been lived in prior to acquisition by the taxpayer.

"Purchase price" for the purpose of computing the credit means the adjusted basis of the residence. One situation where the adjusted basis is less than the purchase price would be if the taxpayer had deferred part or all of the gain on the sale of the residence being replaced by the new one. See Chapter 3 for a computation of deferred gain.

The credit applies to a new principal residence:

(a) the construction of which began before 26 March 1975,

(b) which is acquired and occupied by the taxpayer after 12 March 1975 and before 1 June 1977, and

(c) if not constructed by the taxpayer, which was acquired by the taxpayer under a binding contract entered into before 1 January 1976.

Generally, the taxpayer must acquire the residence after 12 March 1975, and before 1 January 1976.

However, the taxpayer may still be entitled to the credit even though the contract was entered into prior to 13 March 1975 if settlement and occupancy occurs on or after that date and before 1 January 1977. Also, the taxpayer is entitled to the credit if he enters into a contract binding for the purchase of a new residence after 12 March 1975 and before 1 January 1976 if settlement and occupancy occurs before 1 January 1977. The contract may be contingent on the taxpayer finding a loan and still be considered binding.

To claim the credit, the taxpayer must attach a statement to the return from the seller certifying that the construction of the residence began before 26 March 1975 and the purchase price was the lowest price at which the residence was offered for sale after 28 February 1975.

If the taxpayer disposes of the residence within 36 months after the date acquired (or the date occupied if constructed by the taxpayer) the taxpayer must recapture the credit.

## Summary

### Introduction

(1) For 1975, if allowable itemized deductions exceed 16% of adjusted gross income up to the maximum discussed earlier, the taxpayer should itemize on Schedule A (Form 1040).

(2) If 16% or less use one of the two types of standard deductions.

### Percentage Standard Deduction

*What is the percentage standard deduction?*

For 1975 the percentage standard deduction is 16% of adjusted gross income.

*What are the limitations on the percentage standard deduction?*

Limitations for 1975 are:

- (1) \$2,300 for single persons, or
- (2) In the case of a married person filing separately (Note citizen married to nonresident alien) up to \$1,300, or
- (3) In the case of married persons filing joint returns, 16% of adjusted gross income up to \$2,600.

*What are the advantages of the percentage standard deduction?*

- (1) Relieves taxpayer from having to substantiate deductions.
- (2) Taxpayer does not have to keep receipts.
- (3) Easier to compute tax.
- (4) Can use optional tax tables if income under \$15,000.

*What taxpayers cannot use the percentage standard deduction?*

- (1) Nonresident aliens
- (2) Estates and trusts
- (3) United States citizens entitled to special benefits accorded income received from a United States possession (other than Puerto Rico).

(4) Individuals filing a short year return in case of a change in accounting period

(5) Taxpayer whose spouse itemized deductions.

## Itemized Deductions—Schedule A

### General

(1) See Schedule A (Form 1040) in Pub. 17 (filled-in example)

(2) Some of the items deducted here are:

- (a) Medical
- (b) Contributions
- (c) Taxes
- (d) Interest
- (e) Casualty losses
- (f) Miscellaneous deductions
  1. Uniforms
  2. Alimony
  3. Education
  4. Investment expenses
  5. Safe deposit boxes
  6. Returns preparation fee
  7. Political contributions
  8. Household and dependent care expenses

### Medical Expense

Expense for diagnosis, cure, treatment, mitigation or prevention of disease.

(1) Look at Schedule A (Form 1040) and note 1% and 3% rules for medicines and other medical expenses respectively.

*Note:* 1% and 3% rules apply to all taxpayers and dependents.

Most military do not have this expense since they receive free treatment.

- (2) Deductible when paid.
- (3) Reduced by insurance recovery.
- (4) See text for expenses deductible and nondeductible.
- (5) See Pub. 17, chapter 21.

### Contributions

(1) *Deductible:*

- (a) Official ship, station or post funds used for recreation, welfare or amusement of service personnel.
- (b) Chests—Community
- (c) Church and Synagogues
- (d) YMCA, boys clubs
- (e) DAR, Amvets, American Legion

(2) *Nondeductible:*

- (a) Parochial school tuition fees
- (b) Lodge dues
- (c) Gifts to individuals
- (d) Pre-adoption expenses
- (e) International organizations
- (f) Orphanages in foreign countries, because they are not U.S. organizations or creations
- (g) Communist organizations.
- (3) Cash or property (FMV note: (1) tax saving on stock donated to charity (2) FMV of old clothes is nominal).
- (4) Deductible only in the year paid—not pledged.



(5) In lieu of gas and oil on auto used for charitable organization 7¢ per mile may be claimed. *Note:* Depreciation and insurance are not deductible.

(6) 20% and 50% limitation.

(7) Carryover. (5 years for 50% or 30% type contributions).

(8) Pub. 17, chapter 23.

### Taxes

(1) Look at Schedule A and note listed taxes allowed.

*Note:* Foreign personal property and gasoline taxes are not deductible.

*Note:* Sales tax can be estimated from table in instructions for 1040 booklet.

(2) Look at text for nondeductible taxes.

(3) Deductible when paid. State income taxes withheld plus tax due for prior year paid in current year are deductible in current year.

(4) Pub. 17, chapter 22.

### Interest

There will be allowed a deduction all interest paid or accrued within the taxable year on indebtedness. To be deductible, interest must be on a debt for which the taxpayer is legally liable. Nonbusiness interest payments, such as that paid on a mortgage on a residence, on a personal loan, or on an installment purchase of personal property, may be deducted on Schedule A. In case the interest on an installment purchase is stated separately, the amount actually paid is deductible. However, where the actual interest is not distinguishable from other charges, a deduction may be made of 6 percent of the average unpaid balance (computed by taking 1/12 of the sum of the unpaid balances as of the first day of each month), provided this amount does not exceed the ratable share of the total finance charges allotted to the taxable year.

A deduction may be taken for interest paid on tax deficiencies, but any penalties involved are not deductible. The interest on a discounted note, which is to be repaid in a lump sum, is not deductible by a cash basis taxpayer until the note is paid. Where the discounted note is repayable in installments, a proportionate part of the discount is deductible for each payment, on the cash basis. Interest paid for funds used to purchase tax-exempt securities is not deductible.

### Casualty Losses

This provision applies to the loss of property not connected with a trade or business if such loss arises from fire, storm, shipwreck, or other casualty or from theft. Nonbusiness casualty and theft losses of individuals will be deductible only to the extent the loss from each casualty or theft exceeds \$100.

Where two items of loss result from a single event, only one \$100 reduction is required. On joint returns, the taxpayers are treated as one taxpayer and therefore

separate losses sustained in the same event result in only one \$100 reduction.

(1) The amount of the deduction is the lesser of (a) the difference between the fair market value of the property immediately before and immediately after the casualty, or (b) the taxpayer's adjusted basis in the property, less the amount of any reimbursement or insurance.

(2) The property subject to the loss must have been the property of the taxpayer and the loss is deductible only in the year sustained regardless of whether repairs are made that year, a subsequent year, or never made.

(3) A theft loss is deductible in the year it is discovered.

*Note:* See text for losses not deductible.

### Miscellaneous Deductions

The following deductions all go in the last section of Schedule A (Form 1040):

(1) *Uniforms*—military—nondeductible except braid, corps, devices, campaign bars, etc. Fatigues can, in certain situations depending on certain local military regulations, be deductible to the extent expenses exceed allowances.

(2) *Alimony*—If the taxpayer is legally separated or divorced, separate maintenance payments made by him are taxable to his former wife and deductible by the taxpayer if these payments are:

(a) required under the terms of the decree of separation or divorce;

(b) paid in discharge of a legal obligation based on the marital relationship;

(c) paid after the decree; and

(d) are periodic payments.

"Periodic payments" are payments of a fixed amount for an indefinite period, or payments of an indefinite amount (as 10 percent of a variable income) for either a fixed or indefinite period. Under certain conditions "installment payments" or other payments made under a separation agreement entered into after August 16, 1954, or a decree for support after March 1, 1954, may be classified as "periodic payments" and be taxable to the wife and deductible by the husband.

(3) *Education*—deductible if for purpose of

(a) Maintaining present job and not to obtain a better job.

(b) Education expenses are: tuition, laboratory fees, books, etc.

(4) *Expenses for Child and Dependent Care*—

(a) The maximum deduction is \$400 per month.

(b) Must be incurred to enable taxpayer to be gainfully employed.

(c) Taxpayer must maintain household which includes as a member one or more qualifying individuals.

(d) Qualifying individual is:

(1) taxpayer's dependent under 15,

(2) taxpayer's dependent who is disabled, or

(3) taxpayer's spouse who is disabled.

(e) Limitation on deduction when taxpayer's ad-



justed gross income exceeds \$18,000 (or \$35,000 for calendar years beginning in 1976).

(f) Reduction of deduction by certain payments received by disabled dependent and disabled spouse.

(g) Married couples must file joint return unless they qualify as not married under married but living apart test.

**Nondeductible Expense (See Text)**

## Quizzes for Chapter 5

### True-False Quiz

Indicate whether each of the following statements are true or false or deductible or nondeductible, by inserting "X" in the appropriate box.

- All interest prepaid on a three-year loan is not deductible in the year of payment by a cash basis taxpayer.  
 True       False
- Legal fee of \$50 paid by an individual to have Federal income tax return prepared.  
 Deductible       Not deductible
- Commercial school tuition paid by a typist to obtain a position as private secretary.  
 Deductible       Not deductible
- The cost of a uniform in excess of reimbursement by an officer in the Armed Forces Reserves, used during summer training periods.  
 Deductible       Not deductible
- Insurance premiums paid on a dwelling owned and occupied by a taxpayer.  
 Deductible       Not deductible
- Federal tax on railroad transportation incurred on a vacation trip.  
 Deductible       Not deductible
- Interest paid on Federal income tax deficiency.  
 Deductible       Not deductible
- Y, a single taxpayer, filed his calendar year income tax return. He had adjusted gross income of \$10,000 and claimed a medical deduction, computed as follows:

Drugs and medicine .....	\$180
Less 1% of adjusted gross income .....	100
Remainder includible in medical expense .....	\$ 80
Doctor, dentist, etc. ....	\$1,200
Less amount reimbursed .....	800
Amount not reimbursed .....	400
Net medical expenses .....	480
Less 3% of adjusted gross income .....	300
Medical deduction claimed .....	\$180

Y's computation of his medical deduction is correct.

True       False

### Multiple Choice Quiz

*Directions*—Circle the appropriate letter to select the answer to each of the following questions.

- Which of the following expenses are not deductible?
  - Alimony payments
  - Taxes on personal residence.

- Taxes on rental property.
  - Repairs on rental property.
  - Repairs on personal residence.
- Which of the following insurance premiums paid would be deductible?
    - Insurance on personal dwelling.
    - Insurance on personal jewelry.
    - Insurance on daughter's life.
    - Liability insurance on personal auto.
    - None of the above.
  - Capt. Smith incurs and pays the following during the year: general property taxes on residence \$105, State income tax \$110, Federal Income Tax \$416, excise tax \$5 and State gasoline tax \$25.

What is Capt. Smith's maximum allowable deduction for taxes on his calendar year cash basis return?

- \$656.
  - \$546.
  - \$240.
  - \$245.
  - \$215.
- Jane Adams, upon arriving home from a theater on 10 September, discovered that her diamond ring was missing. She remembered taking off the ring in the wash room of the theater. She called the theater manager but the ring was not found. She had purchased the ring in 1973 for \$475. An appraiser had recently valued the ring at \$550. What is Jane's allowable loss on her return?
    - \$550.00.
    - \$512.50.
    - \$475.00.
    - The replacement cost.
    - None.
  - In May, Commander Black learned that his personal residence, which cost \$18,000 in 1954 was severely damaged by termites. The inspector told him that the termites had infested the property for several years. The fair market value prior to the discovery of the damage was \$28,000 and after the discovery was \$12,000. He paid \$14,000 to repair the damage on 15 August. What is his allowable loss?
    - \$28,000.
    - \$16,000.
    - \$14,000.
    - \$7,200.
    - None.
  - An individual could not deduct a contribution to which of the following organizations?
    - Daughters of American Revolution.
    - American Bar Association.
    - Church, for pew rent.
    - Camp Fire Girls.
    - American Legion.

### Question-Answer Quiz

- Under what circumstances may a U.S. taxpayer use the standard deduction—
  - What are the limitations of this deduction?
  - If a taxpayer chooses to use the standard deduction, may he also claim a foreign tax credit?
  - May a husband and wife filing separate returns each use the standard deduction or itemize their deduction, at their individual discretion?
- Captain Reynolds on duty afloat on a ship based in the Mediterranean, made gifts and donations to numerous persons and organizations as shown below. Disregarding limitation, indicate the items and amounts which may be deducted on his return as contributions.
  - His personal services and the use of his auto-

mobile at a cost of \$10, for the benefit of the Italian Boy Scouts.

- b. A gift of 10 shares of United States Steel common stock held over 6 months to Harvard University, his Alma Mater. This stock cost him \$50 per share and the market quotation on the date of gift was \$55 per share.
  - c. A cash gift of \$20 to the Italian Red Cross.
  - d. A donation of 2 pints of blood for the benefit of the wife of a fellow officer who was injured in an Italian train wreck.
  - e. Weekly donations to the Chaplains fund on his ship, in the total amount of \$52.
  - f. The donation of the use of his car, operating 320 miles, to assist in a fund-raising campaign for the American Red Cross.
3. Which, if any, of the following items would be deductible on the return of a Second Class Petty Officer of the U.S. Navy, on duty in the Indian Ocean, if he itemizes his deductions?
- a. Auto license of \$20 paid to his home state (not ad valorem).
  - b. Real estate taxes paid to his home state on his home which was not rented during the taxable year.
  - c. Income taxes paid to his home state.
  - d. Fishing license issued by the local government of Okinawa.
  - e. Sewer tax paid to home city, representing his share of construction costs of a community sewer for use in his home area (assume home is not rented).
  - f. Outgrown suit of clothes given to American Red Cross. Fair market value of \$5 (cost \$50).
4. In connection with the sale of his personal residence, Sgt. Wm. Paton, who was on duty in Norway, received \$125 monthly from the purchaser. Each payment represented principal and interest of \$100; real estate taxes of \$20 and insurance premium payments of \$5. Sgt. Paton agreed to accumulate the payments made on taxes and insurance and to pay the annual tax and insurance bills when due.
- a. Is Sgt. Paton entitled to any deduction for the payments of taxes and insurance which he made subsequent to the sale of the property? If not, explain fully.
5. Indicate by placing an X in the appropriate column whether the following items are deductible or non-deductible on the U.S. income tax return of a cash basis taxpayer who is a member of the Armed Forces on duty outside the United States.
- a. The cost of an Army Dress Blue uniform (less shoulder boards or gold-stripe on pants) including cape.
 

<input type="checkbox"/> Deductible	<input type="checkbox"/> Nondeductible
-------------------------------------	--
  - b. The cost of a full Army Green uniform (less braid).
 

<input type="checkbox"/> Deductible	<input type="checkbox"/> Nondeductible
-------------------------------------	--

c. The cost of gold braid for decoration of cap and uniform.

- |                                     |  |
|-------------------------------------|--|
| <input type="checkbox"/> Deductible | <input type="checkbox"/> Nondeductible |
|-------------------------------------|--|
- d. The cost of a treatise on investments by the taxpayer who has an investment portfolio.
- |                                     |  |
|-------------------------------------|--|
| <input type="checkbox"/> Deductible | <input type="checkbox"/> Nondeductible |
|-------------------------------------|--|
- e. An unpaid pledge to an educational institution in the United States.
- |                                     |  |
|-------------------------------------|--|
| <input type="checkbox"/> Deductible | <input type="checkbox"/> Nondeductible |
|-------------------------------------|--|
- f. Interest paid on money borrowed to purchase a diamond ring.
- |                                     |  |
|-------------------------------------|--|
| <input type="checkbox"/> Deductible | <input type="checkbox"/> Nondeductible |
|-------------------------------------|--|

### Continuing Problem

#### Part 3—Deductions

A. Following are expenses of John A. and Betty Mankat, whose joint return you started preparing earlier. Determine the amounts allowable as Itemized Deductions and enter the appropriate information on Schedule A, (Form 1040); then carry forward the total to line 44.

#### Interest:

1st National Bank .....	\$ 48.00
Department Stores .....	7.00

#### Contributions:

St. Anthony's Church, Oxon Hill, Md. ....	150.00
United Givers Fund, Washington, D.C. ....	100.00
USAF Base Chapel (Germany) .....	40.00
Frankfurt Children Orphanage .....	50.00
Daughter Ann's Parochial School fees .....	200.00

#### Taxes:

"Purchase tax" (sales tax) levied on the retailer by foreign country, included in purchase price	\$ 42.00
Dog license .....	10.00
Maryland sales tax .....	155.00
Maryland gasoline tax .....	31.00
Maryland income tax .....	500.00

#### Other:

Alimony .....	\$ 600.00
Insignia for uniform .....	12.00
Dependent care expense for Ann (qualifying) ..	520.00

#### Casualty:

Auto accident: cost of car .....	\$3,000.00
FMV before accident .....	2,200.00
FMV after accident .....	900.00
Received from insurance company .....	500.00

Lieutenant Mankat's mother, Mary Mankat, is 67 years of age and lives in rented quarters in Dallas. Lieutenant Mankat contributed \$500.00 to her support during the year. She received \$800.00 from other, non-taxable, sources. She worked part-time and earned \$595.00. This constituted her entire support for 1975. She did not spend any of her savings during the year. She remarried on 23 December 1975 and has chosen to file a joint return with her new husband for that year.

# Chapter 6. Rental Income and Depreciation

## Objectives

- (1) To familiarize participants with rental income and how it is handled for tax purposes.
  - (a) Rental income
  - (b) Rental expenses
- (2) To familiarize participants with the three principal methods of computing depreciation.

## Rental Income

Gross income specifically includes income from rents. "Rent" is generally the money or consideration received for the occupancy of real estate or use of personal property.

## When Reported

Rental income may be reported on the cash or accrual basis, but rent received in advance must be included in income in the year received regardless of the accounting method used. In addition, the amount of advance rent may not be reduced by expected expenses.

*Example:* Taxpayer enters into a ten-year lease to rent his property for an annual rental of \$5,000. In the first year, in addition to \$5,000 for that year's rent, he also receives \$5,000 in advance for the last year of the lease. Taxpayer must report \$10,000 in income without reduction for anticipated expenses or losses in the first year.

Security deposits received for the lessee's performance under the lease are not usually included in income when received. However, they are included as income when and to the extent appropriated by the lessor because of a default by the lessee. If an amount designated as a security deposit is to be applied as payment of rent for the last year of the lease, it is advance rent and must be reported when received.

Amounts received by a landlord from a tenant for cancellation of a lease are income in the year received. Any expenses of the landlord paid by the tenant must also be included in the landlord's income since, in effect, the tenant is paying additional rent.

Improvements by a tenant to leased property, generally are not income to the landlord either when made or when the lease ends. Gain or loss is recognized only when the property is disposed of. But, when a tenant makes an improvement instead of paying rent, the fair market value of the improvement is income to the landlord when the improvement is made. When the fair market value of these improvements are included in gross income as rent, an adjustment to the basis of the property may be made.

## Rental Expenses

The expenses deductible from gross rents are divided into three broad groups: (1) depreciation, (2) repairs, and (3) other expenses.

## Repairs

Expenditures for keeping the rental property in an ordinarily efficient operating or usable condition are considered a repair expense. Any expenditure which appreciably adds to the value, utility, or useful life of the property is a capital expenditure and not a repair expense.

## Other Expenses

Other expenses include such items as advertising, janitor and maid service, water, fuel, fire and liability insurance, taxes and interest. Insurance premiums paid in advance are deductible over the period the insurance is in effect. A worthless debt from unpaid rent is not deductible unless the unpaid amount was included in income.

## Part Business--Part Personal

If a taxpayer rents his residence to a tenant, the depreciation, repairs and other expenses incurred in connection with such property are deductible in full. However, if only part of the residence is rented out, the expenses must be allocated.

*Example:* A taxpayer owns an eight room house, and rents two rooms to college students. In determining the amount of expenses attributable to the rental portion, the house is considered  $\frac{1}{4}$  rented. The following expenditures would be prorated as shown:

	Total	Deductible Allocations Two Rooms
Utilities .....	\$400 x $\frac{1}{4}$	\$100
Repairs .....	200 x $\frac{1}{4}$	50
Taxes .....	600 x $\frac{1}{4}$	150
Interest .....	300 x $\frac{1}{4}$	75
Depreciation .....	500 x $\frac{1}{4}$	125

Upon converting rental property into his personal residence, the owner will be deprived of deductions for depreciation, upkeep, and other business-type expenses such as insurance. Mortgage interest and real estate taxes will continue to be deductible, but only as an itemized deduction from adjusted gross income.

The conversion of the property to a personal residence will not be a "disposition" for the purposes of the depreciation recapture rules. The recapture will occur when the property is sold or otherwise disposed of in a transaction in which gain is recognized.

A taxpayer who rents to a friend or relative without the objective of making a profit may deduct certain items such as interest and state and local property taxes. These are deductible whether or not profit is the objective. The taxpayer may also deduct certain items that would normally be deductible only if the rental activity were engaged in for profit. These deductions are limited to the extent that gross income from the rental exceeds deductions allowed whether or not the rental is engaged in for profit. The deductions must be taken in the following order:

- (1) interest and taxes;

(2) operating expenses, except those in item (3) (to the extent of income);

(3) depreciation and other basis adjustment items.

Where property is held primarily for personal use, but is occasionally rented, such as a vacation home, the expenses are deductible only to the extent of any rental income received.

## Depreciation

In this section, depreciation will be defined and its purpose discussed along with an explanation of the methods available to the taxpayer for computing depreciation.

### Depreciation Defined

In general, depreciation of an asset, due to such causes as wear and tear, or normal obsolescence, is a means of spreading the cost or other basis of an asset to the period of time over which it is estimated that a benefit will be derived from the ownership of such asset.

### Conditions Necessary to Allowance of Depreciation

There are three basic conditions which must exist before an allowance for depreciation may be taken:

(1) There must be a depreciable interest in property. That is, the taxpayer must be the owner of the property.

(2) The property must be used in the taxpayer's trade or business, or held for the production of income.

(3) The property must have a limited and determinable life because the investment to be recovered by depreciation allowances must be charged off over the useful life of the property. If an asset would last indefinitely there would be no depreciation allowance. Basically, this is the reason why land is not depreciable.

### When Depreciation is Allowed

Depreciation begins when the asset is placed in service and ends when it is retired from service. A proportionate part of one year's depreciation is allowable for the part of the first and last year during which the asset is in service. For example, if a taxpayer using the calendar year purchases an asset and places it in service on July 1, he is entitled to six months' depreciation for the year.

A taxpayer should claim the proper depreciation deduction for each tax year. If a taxpayer failed to deduct reasonable depreciation sustained in prior years, he may not deduct the unclaimed depreciation in the current or any later tax year.

### Property Subject to Depreciation

In general, the property subject to depreciation may be classified into two categories: (1) tangible property and (2) intangible property.

(1) Tangible property consists of real property and personal property. Some examples of such property are:

(a) Buildings used for business purposes or held for rent.

(b) Furniture, fixtures, and machinery used for business or rental purposes.

(2) Some examples of intangible property are:

(a) Patents, copyrights, licenses and franchises.

(b) Contracts which have a definite life.

### Basis for Computing Depreciation

In general, the basis for computing depreciation is the same as the basis used to determine gain if an asset is sold. This means that basis is dependent upon the manner in which an asset is acquired. If an asset is acquired by an outright purchase, the basis is cost. If an asset is acquired by an exchange with no cash paid or received, the basis is the same as the basis of the asset given up in the exchange. If the asset is acquired by gift, the basis shall be the same as it would be in the hands of the donor. If the asset is acquired by inheritance, the basis is the fair market value at decedent's death or later alternative date, if elected.

*Example:* If a taxpayer exchanges rental property having an adjusted basis of \$20,000 for another rental property having a fair market value of \$35,000, his basis in the property acquired is the same as the property given up, or \$20,000.

The term "adjusted basis" may be defined as the cost of the property, plus improvements less depreciation deducted or deductible, whichever is greater.

In the case of property acquired for personal use such as a residence or automobile, and subsequently converted to business use, the basis of the property is its cost or fair market value, whichever is lower, at the time of conversion.

If an asset is used for both business and personal purposes, only that part of the depreciation which is properly allocable to business may be deducted.

### Allocation of Purchase Price Between Land and Building

If a taxpayer purchases improved real estate, the purchase price must be allocated between land (nondepreciable property) and the building.

*Example:* Taxpayer purchases an apartment building and land for \$30,000. Fair market value of the entire property is \$30,000, and the fair market value of the building is \$20,000. The total price should be allocated \$20,000 to the building and \$10,000 to the land.

### Accounting for Depreciable Property

Depreciable property may be accounted for by treating each individual item as an account, or by combining two or more assets in a single account. Assets similar in kind with approximately the same useful lives may be grouped together or assets may be segregated according to use.

### Determination of Useful Life or Rate

The useful life of a depreciable asset is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. The useful life is dependent upon the age and condition of the asset when acquired,



taxpayer's policy as to repairs and upkeep, and other conditions.

If the taxpayer does not have adequate experience in determining a useful life, or the asset is new to him, he may use the general experience in the industry.

### Salvage Value

Salvage value is an estimate of the approximate amount that will be received upon the sale or other disposition of an asset, when it is retired from service. This estimate is determined by the taxpayer at the time the asset is acquired. Unless the declining balance method of computing depreciation is used, salvage value must be deducted from the basis of the asset to determine the basis to be used in computing the annual depreciation deduction. If personal property (other than livestock) with a useful life of three or more years is acquired, salvage may be reduced by any amount up to 10 percent of the basis of the property.

### Methods of Computing Depreciation

In computing depreciation any reasonable method which is consistently applied by the taxpayer may be used. However, the three methods which are commonly used are: (1) the straight-line, (2) the declining balance, and (3) the sum-of-the-years-digits.

Any change in the method of computing the depreciation allowances with respect to a particular account is a change in method of accounting, and such a change will be permitted only with the consent of the Commissioner, except that certain changes to the straight line method of depreciation will be permitted without consent.

#### Straight-line Method

The straight-line method of computing depreciation may be used for either new or used property. Under this method, the cost or other basis less salvage value, is deductible in equal annual amounts over the estimated useful life of the asset.

*Example:* On January 2, taxpayer purchased a machine for \$2,800. He estimated the useful life of such machine to be three years and the salvage value to be \$400. However, he elects to disregard \$280 of salvage value (10% of \$2,800). His annual depreciation would be computed as follows:

Cost of machine .....	\$2,800
Less:	
Estimated salvage value .....	120
Depreciable basis .....	<u>\$2,680</u>
Annual Depreciation (\$2,680 x 33⅓%) .....	<u>\$ 893</u>

#### Declining Balance Method

Under the declining balance method there are three maximum rates that may be used—double the straight line rate, one and one-half the straight-line rate, and one and one-quarter the straight line rate. The depreciation is computed by subtracting from the basis each year the depreciation of the preceding year and multiplying the rate times the constantly declining balance. Salvage

value is not deducted prior to applying the rate. However, property must not be depreciated below its reasonable salvage value. Under this method the greatest amount of depreciation is taken in the first year of use, with continually decreasing amounts in later years.

#### Twice the Straight Line Rate

This maximum rate may be used on property having a useful life of 3 years or more that is acquired new or is constructed by the taxpayer after December 31, 1953. If real property, it must be acquired before or construction begun before July 25, 1969, and the original use of the property must start with the taxpayer. However, all new residential rental property may be depreciated at twice the straight-line rate. (To qualify as residential rental property 80% of the gross rental income from the property must come from the rental of residential units, not transient housing, for each year twice the straight-line rate is used.)

*Example:* Taxpayer purchased a new saw for his business two years ago. Cost of the saw was \$4,000 and estimated useful life is 10 years. Under the straight line method of computing depreciation, ten years is equivalent to a rate of 10%. Since the saw qualifies for twice the straight line rate, or 20%, depreciation would be computed as follows:

	Computation	Allowable Depreciation
Last year ..	\$4,000 times 20%	\$800
This year .. (\$4,000-\$800)	\$3,200 times 20%	\$640
Next year .. (\$3,200-\$640)	\$2,560 times 20%	\$512 etc.

#### One and One-half Times the Straight Line Rate

This rate may be applied to used tangible personal property (or new property acquired before January 1, 1954), having a useful life of 3 years or more, used real property acquired before July 25, 1969, and new real property (other than new or certain used residential rental property) acquired after July 24, 1969.

*Example:* If in the above example the taxpayer had purchased a used saw, the maximum declining balance rate would be 15% (1½ times the straight line rate of 10%). Thus, the depreciation for the year of purchase would be \$600 (15% of \$4,000) and for this year would be \$510 (15% of \$3,400), etc.

#### One and One-fourth Times the Straight Line Rate

This is the rate that can be used on used residential rental property acquired after July 24, 1969, and having a useful life of 20 years or more that meets the 80% gross rental test explained above.

*Example:* Taxpayer purchased a used apartment building at the beginning of 1974 for \$100,000. The estimated useful life of the building is 25 years. 93% of the gross rental income is from dwelling units. Under the straight line method, the rate would be 4%, but since the property qualifies for one and one-fourth times the straight line rate, the declining balance rate would be 5%. Depreciation for 1974 would be \$5,000 (5% of \$100,000), for 1975 depreciation would be \$4,750 (5% of \$95,000).



### Sum-of-the-Years-Digits Method

This method is allowed only on property which meets the requirements for twice the straight line rate explained under the declining balance method.

The depreciation is computed by applying a different fraction each year to the basis of the property less its salvage value. The denominator of the fraction is the total of the numbers representing the years of useful life of the property. Thus, if the useful life is five years, the denominator is 15 ( $1 + 2 + 3 + 4 + 5 = 15$ ).

The numerator of the fraction is the number of years of remaining life at the beginning of the year for which the computation is made. Thus, if the useful life is five years, the fraction to be applied to the cost minus salvage to figure depreciation for the first year is  $5/15$ . The fractions for the remaining years would be  $4/15$ ,  $3/15$ ,  $2/15$ , and finally  $1/15$ .

*Example:* On January 2, 1971, taxpayer purchased an asset for \$3,400 having an estimated useful life of five years. The estimated salvage value is \$400. The annual depreciation allowance would be:

	Cost or other basis less salvage	Fraction	Depreciation Allowable
1971 .....	\$3,000	$3/15$	\$1,000
1972 .....	\$3,000	$4/15$	800
1973 .....	\$3,000	$3/15$	600
1974 .....	\$3,000	$2/15$	400
1975 .....	\$3,000	$1/15$	200

### Additional First-Year Depreciation

A taxpayer, except a trust, can elect to claim an initial deduction equal to 20% of the investment in qualifying property in addition to the ordinary first-year depreciation deduction. This 20% applies only to \$10,000 of investment on a single or separate return and to \$20,000 on a joint return. The full cost or a fractional part of the cost of an item may be selected for the additional depreciation deduction, but only up to an aggregate cost of \$10,000 (\$20,000 on joint return). The limit applies to each taxpayer, not to each business in which he has an interest.

Salvage value is not considered in computing the 20%. However, in computing normal depreciation, the basis must be reduced by both the additional first-year allowance and salvage value (if salvage value is a factor in the method of depreciation used).

*Example:* On January 2, a taxpayer, who uses straight-line depreciation, paid \$10,000 for a machine with a useful life of ten years. Salvage value was estimated to be \$1,500. The initial first-year allowance is \$2,000 (20% of \$10,000). This reduces the basis for normal depreciation to \$6,500. Normal depreciation for the first year is \$650 (10% of \$6,500). The total allowance for the year is \$2,650.

The additional first-year allowance is allowed in full, regardless of when during the year the property is acquired or the depreciation method used.

### Qualifying Property

To qualify for the additional first-year depreciation the property must be tangible personal property and must have a useful life of at least six years when acquired. The property may be new or used.

### Election

To use the additional first-year depreciation allowance the taxpayer has to make an election. He makes this election on a timely filed return showing the additional first-year depreciation on a separate line for each asset selected for such additional write-off.

For more detailed information concerning depreciation methods see Chapter 20 in Publication 17.

## Quiz for Chapter 6

### Continuing Problem

#### Part 4

#### A. Rental Income

From the following information, prepare a SCHEDULE E

Rental income: House (wood and brick) located at 1012 Main St., Dallas, Texas.

Amount of rent: \$200.00 per month for 12 months of 1975.

Information for depreciation:

The house and lot were purchased 12 December 1967 for \$22,800.00; of which \$20,000.00 was the cost of the house. Lieutenant Mankat lived in the house until 28 December 1972. The tenant moved in on 1 January 1973. Fair market value of the house on 28 December 1972 was \$25,200.00.

Assume: (1) No salvage value to be considered.  
(2) The house was rented unfurnished.

Method of depreciation: Straight line

Estimated useful life: 40 years

Other expenses. Interest on Mortgage	..	\$500.00
Real estate taxes	.....	400.00
Insurance	.....	50.00
Realtor fee	.....	120.00

#### B. Problem Completion

Complete the income tax return of John A. and Betty Mankat begun earlier. Compute income tax and balance of tax due or overpayment. Additional information needed:

Home address: 22 Greenhill Ave., Oxon Hill, Maryland 20021, Prince George's County

Lieutenant and Mrs. Mankat have one child, Ann, age 12, who lives with them, and whose exemption they are entitled to claim.

Income tax withheld from Lieutenant Mankat's salary by U.S. Air Force: \$1,246.40.

Income tax withheld from Mrs. Mankat's salary by U.S. Air Force: \$735.60.

Fill in all appropriate spaces on Form 1040, supplying all missing information as necessary.

#### C. Amended Return

Suppose on 15 May 1976 Lieutenant Mankat realizes he forgot to claim a \$400 interest payment made to the National Bank of Dayton, Ohio on his original return. Prepare a Form 1040X correcting the original filing. (The 1040X can be used to correct any errors, omission of income, and unclaimed deductions such as itemized deductions. This form is designed to expedite the processing of the claim.)

# Chapter 7. Aliens

## Introduction

This chapter discusses the two types of aliens, i.e., resident and nonresident. Filing requirements of resident aliens (foreign nationals who are residents of the U.S.) are briefly discussed. Special emphasis is placed on soldiers married to nonresident aliens (foreign nationals not living in U.S.).

## Objectives

Participants should be able to explain the following concepts:

(1) The different status of aliens, i.e., resident and nonresident.

(2) The unusual tax principles applicable to situations where U.S. citizens are married to nonresident aliens.

(3) The application of community property law to the above situation.

Applicable form for this chapter:

Form No.

1040NR, U.S. nonresident alien income tax return filed with the IR Service Center, 11601 Roosevelt Blvd., Phila., Pa. 19155.

## Returns Filed by Aliens

For income tax purposes, aliens are divided into two classes:

- (1) resident aliens; and
- (2) nonresident aliens.

### Resident Aliens

A resident alien is an alien who is actually present or residing in the United States and is not merely a transient or sojourner. For income tax purposes, an alien whose stay in the United States is limited to a definite period by immigration laws is generally held not to be a resident alien. However, a rebuttable presumption of residence arises if an alien has resided in the U.S. for as much as one year.

The same provisions for filing returns apply to resident aliens that apply to citizens of the United States.

### Nonresident Aliens

A nonresident alien is an alien individual whose residence is not within the United States and who is not a citizen of the United States. He is liable for tax only on income from sources in the United States, and he files a Form 1040NR on or before 15 June following the end of the calendar year. Why it is important for tax purposes to determine the residency status of an alien is now obvious. A resident alien is taxed on *all* of his income, wherever the source may be, but a nonresident alien is liable only for his U.S. sourced income.

For detailed information concerning the tax problems of an alien an excellent publication is prepared by the Internal Revenue Service. (Publication 519, U.S. Tax Guide for Aliens.)

Discussion of dual-status taxpayers (taxpayers who are nonresident aliens and resident aliens for part of the tax year) is not included in this course; however, Internal Revenue Service Publication 519 thoroughly covers the tax problems in this area. A dual-status taxpayer is required to file a Form 1040.

## Alien Members on Active Duty

Alien members on active duty are treated, for military administrative purposes, as resident aliens, and income tax is withheld on the same basis as that of citizens of the United States on active duty. This does not mean that at the end of a taxable year an alien is precluded from proving to the District Director of Internal Revenue that he was in fact, during the year, a nonresident alien. A resident alien or citizen of the United States is liable for tax on income sourced both within and without the U.S.A.; and files a Form 1040 return. A nonresident alien, however, is liable only with respect to income sourced *within* the United States. The source of compensation for services rendered (i.e., military taxable pay) is the place where the services are performed. A nonresident alien who has performed services in the United States during the tax year files an annual tax return on Form 1040NR, regardless of the amount of his U.S. sourced income.

## Enlistees

As a general rule most alien enlisted personnel in the Armed Forces would likely qualify as resident aliens for tax purposes. This would almost certainly be true of the alien who has lived in the United States for a number of years before enlistment. In time of peace the pertinent enlistment requirements of the Armed Service stipulate that no person may be accepted for enlistment unless he is a citizen or has been lawfully admitted to the United States for *permanent residence* under the applicable immigration laws. These two characteristics, i.e., voluntary enlistment in the Armed Forces and admittance for permanent residence, in most cases, are enough to classify an alien enlistee as a resident alien. Aliens who are present in the United States merely because of military assignment and who have a genuine residence outside of the United States are nonresident aliens. A preponderance of Filipino enlisted personnel in the Navy are not immigrants and they do not intend to become citizens.

## Military Personnel Married To Aliens

### General Rules

It is most important to remember one rule, . . . a *joint* return may not be filed if either spouse was a nonresident alien during *any* part of the tax year.

Therefore, soldiers married to nonresident alien wives may not file a joint return.

The nonresident alien spouse need not file a Federal income tax return reporting her income from sources without the United States during the period that she remains a nonresident alien.

The U.S. citizen:

- (1) May claim an exemption for his wife if she has no U.S. sourced income.
- (2) Is limited to a \$1,300 maximum percentage deduction for 1975.
- (3) Is limited to a low income allowance of \$950 for 1975.
- (4) Under certain conditions, may claim head of household status by virtue of maintaining a household for a relative (not his spouse).

### Servicemen Domiciled in Community Property States

(Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington)

If the husband is domiciled in a community property State, serving in a military capacity abroad, and married to a nonresident alien wife, half of his earnings belong to her and half of his withholding tax is attributable to such earnings. Conversely, if the wife has income, half of her income belongs to him. This is not the case, however, where the husband elects to have foreign community income treated specially. To do so he must file the "Election for Treatment of Income Subject to Community Property Laws." Under this election community property income will be generally treated as belonging to the spouse earning it. In this connection ownership of such income is determined in accordance with the community property laws of the foreign domicile. The half of the husband's earnings belonging to the wife is not subject to tax because a nonresident alien does not have to pay tax on income from sources without the United States; and as previously stated, the source of military pay is the place where the services are performed. Such a marital situation results in a tremendous tax savings.

**Example:** If a serviceman domiciled in Arizona is on duty in England and marries a British citizen, one-half of his pay thereafter is considered to be his wife's income, and since his pay is for services performed in England it is considered to be from a source outside of the United States. While his wife remains a nonresident alien she is not required to report her half of his pay or any of her own income earned outside the U.S.A. for Federal income tax purposes.

The husband would file a Form 1040 to report all his pay before marriage and one-half of his pay thereafter, and half of her pay thereafter. He may take credit for all taxes withheld before marriage and one-half of those withheld after marriage. He may claim a foreign tax credit on the taxes paid to the foreign government on the wife's foreign earnings reported by the husband.

In addition, he may follow the three general rules outlined above.

She would file a Form 1040NR showing no income and claim refund for one-half of the taxes withheld after marriage.

What constitutes U.S. sourced income to a nonresident alien spouse of a serviceman domiciled in a community property state is interesting but complicated. Generally, all interest and dividend income received by a nonresident alien individual from the United States or certain domestic and foreign corporations during his tax year constitutes gross income from U.S. sources: However, there are exceptions to this general rule whereby

interest from certain banking institutions, as well as dividends from certain corporations, are not considered as income from U.S. sources. (See Publication 519, U.S. Tax Guide for Aliens.) This is true, even if the stock is maintained in the husband's name.

Dividend income from stocks purchased by the husband before the marriage is not community property in most instances. However, if ownership was changed to joint ownership, it would be community property income. In those cases, one-half of the dividends would belong to the wife.

If the nonresident alien wife has realized U.S. sourced income as the result of applying these community property principles, the income is to be reported on Form 1040NR and taxed at a rate of 30% (or lower Treaty rate), but only if the items of income are not effectively connected with the conduct of a trade or business in the U.S.

Married couples claiming the benefits described in this section should be certain that the wife has the status of a nonresident alien and that the husband is domiciled in a community property State.

As to the former, if the wife has been to the United States, has ever applied for United States citizenship, or has a re-entry permit, there is a possibility that she is a resident alien living abroad and subject to tax, rather than a nonresident alien.

For example, Sgt. Jones marries a nonresident alien while he is stationed in England. After serving his tour of duty there, he and his wife return to the United States on military orders for a further tour of duty. At this point she will generally be considered a resident alien and a subsequent tour of duty outside the United States would not change her residency status.

The question of domicile is extremely complex and important and warrants a somewhat more detailed discussion.

### What Constitutes Domicile for Community Property Purposes

The words residence and domicile are often confused; a person may have several residences but only one domicile. Any temporary place of abode may be a residence, but a domicile is a place of abode fixed and permanent, or at least, of indefinite duration. Time alone does not make the distinction, for a temporary residence may extend over years, while a domicile may be established by the first moment of occupancy. The question of domicile is a mixed question of law and fact; the question being largely one of intention to remain for an indefinite time. The domicile of the wife is generally that of her husband so that for the application of the community property doctrines she does not have to reside in the community property state. The intention of the taxpayer may be determined from actions and declarations. A taxpayer's conduct, inconsistent with vague expressions of intentions, is more persuasive than words. If a taxpayer has left an established domicile, there must be a persisting intention to return, or his domicile will be considered as changed. Where there is doubt on the question of domicile, the domicile of origin may revert.

The following are a few court decisions worthy of note on this subject:

(1) Temporary residence, even if of long duration, merely to transact business or engage in employment is not sufficient for the acquisition or change of domicile. Henry A. Huchins, 8 T.C.M. 809 (1949)

(2) It is essential that the intention to establish a domicile of choice relates to the present and not to the future. Richard M. Gooding, 270 F.2d 765 (D.C. Cir. 1957)

An infinite variety of factual criteria have been used by the courts in determining domicile. Some of these cases are enumerated below:

(1) Original residence, home, business interests, children's school, clubs, attendance, bank accounts, charge accounts and ration books in St. Louis prevailed over business quarters home registry for draft, clubs and membership in business organizations in California. Francis E. Fowler, Jr., 4 T.C.M. 520 (1945)

(2) Residence for 8 months, employment for 8 months and oral testimony of intention to remain in Texas was insufficient against no home, absence of voting, no taxes paid or investments made, parents in Indiana, single income tax return, and no return to Texas thereafter Paul Grafe, 5 T.C.M. 81 (1946)

(3) Birth, original house, voting, poll tax payment, registry for draft, bank account, stock brokerage account, marriage, and central branch of father's export business in Texas prevailed over the conduct of domestic business, auto license, country club membership, and continued residence in North Carolina with wife. Pietro Crespi, 44 BTA 670 (1941)

(4) Mere absence from abode, however long, without intent to change domicile, does not effect a change of domicile. Sampson v. U.S., 63 F. Supp. 624 (D.C.N.D. Cal. 1945)

(5) Residence for 9 months while building a shipyard, visits from family after school and letters indicating the possibility of permanent abode in Texas were insufficient against failure to establish a house, his departure on completing of the job and his living out of a suitcase while in Texas. George C. Westervelt, 8 T.C. 1248 (1947)

(6) The time of change of domicile was found to be the date that certain financial arrangements for a reorganized corporation were concluded, it having been the taxpayer's intention to change his domicile to California when the arrangements were concluded. Northrop v. Comm., 49-2 U.S.T.C. 9406 (CA 9th, 1949)

(7) Original domicile, renting of home, poll tax payment, voting, safe deposit box, visits to church, membership, ownership of real estate, interest in a printing partnership in Texas and residence in Michigan in hotels or furnished apartments prevailed over an originally brief period of employment in Michigan which, during the taxable period involved, had been extended to five years. Eddy R. McDuff, 3 T.C.M. 882 (1944)

(8) A domicile once acquired is presumed to continue until it is shown to be changed. Mitchell v. U.S., 88 U.S. 350 (1874)

(9) However, residence elsewhere rebuts the presumption, and casts upon him who denies it to be a domicile of choice, the burden of disproving it. Ennis v. Smith, 55 U.S. 400 (1852)

(10) Residence in fact, coupled with the purpose to make the place of residence one's home, are the essen-

tial elements of domicile. Supreme Court Decision in Texas v. Florida, 306 U.S. 398 (1939)

The Supreme Court Decision noted in 10 above is the most important decision to date in the attempt to define domicile.

Two examples of military situations connected with community property laws are illustrated as follows:

(1) The fact that a young man born and raised in Maryland spends his young adult life roaming through the United States, working at odd jobs until he arrives in San Francisco, California, where he immediately joins the Navy and ships out to foreign parts would not, in itself, qualify him for the community property rights of California;

(2) A serviceman born and raised in a community property State joins the military as a career man. He marries a nonresident alien from a country which is not a community property country. Upon retirement from the military he decides to remain in the foreign country, raise his family, establish a permanent home there, and devote the remainder of his days to living in such country. For tax purposes he has abandoned his domicile in a community property State by shifting his domicile to a new place. Therefore, he would not be entitled to any split income provisions of community property law.

If the taxpayer is domiciled in a community property state and marries a nonresident alien, the tax savings is substantial. However, the question of domicile, as can be seen from this brief study, must be decided by not only the taxpayer's words but also his actions.

## Information To Be Filed With Returns

When a United States citizen, domiciled in a community property State, is married to a nonresident alien wife and they wish to file Forms 1040 and 1040NR respectively, the returns of both husband and wife should contain a similar statement setting forth names and addresses of both spouses, employers, periods of employment in foreign countries, wages earned by both spouses during such periods, total wages from employment within the United States, details of income tax withheld, the date of marriage, the place where the husband filed his income tax returns, the deductions that the husband has taken, facts concerning his domicile in a community property State, and facts relating to the wife being a nonresident alien.

## Summary

### Returns Filed by Aliens

#### Resident Alien

- (1) When stay exceeds one year—rebuttable presumption arises that taxpayer is a resident alien
- (2) Taxable on income from all sources
- (3) Files Form 1040
- (4) If both spouses are residents or U.S. citizens for entire year they can file a joint return.

#### Nonresident Alien

- (1) One who is neither U.S. citizen nor resident of U.S.A.
- (2) Taxable on U.S. sourced income only.



- (3) Files 1040NR.
- (4) May not file joint return.

#### Alien Members on Active Duty

Enlistees are usually considered resident aliens.

#### Military Personnel Married to Aliens

(1) *Married to resident alien*—Treat like U.S. citizens (joint return, etc. if alien spouse resident for entire year).

(2) *Married to nonresident alien*—(Very important)

(a) He files 1040 return.

(b) May claim wife's exemption only if she has no U.S. sourced income and is not the dependent of another.

(c) Is limited to a \$1,300 percentage standard deduction or \$950 low income allowance for 1975.

(d) May check Unmarried Head of Household status on return if he maintains a household for a dependent (not his spouse because she is an exemption but never a dependent).

(e) The wife need not file a return provided she has no U.S. sourced income. If she does, she will likely file a 1040NR and her husband is precluded from claiming her exemption.

(3) *Husband Domiciled in Community Property State—Married to Nonresident Alien*—(Very important).

(a) He files 1040.

(b) Reports all his salary before marriage and half his salary after marriage, plus half of her earnings after marriage.

(c) Reports all his withholding before marriage and one half his withholding after marriage.

(d) May claim a foreign tax credit if taxes paid to foreign government on half of wife's earnings reported on his return.

(e) Reports all income from assets acquired before marriage whether such income is earned before or after marriage.

(f) Reports one half income from assets acquired after marriage.

(g) May claim wife's exemption if she has no U.S. sourced income other than interest from true bank account. However, one half of the dividend income or capital gain on assets acquired after marriage even though in husband's name would be her U.S. sourced income; therefore no exemption for the wife.

(h) Limited to a \$1,300 percentage standard deduction or \$950 low income allowance for 1975.

(i) He may check Unmarried Head of Household on return and claim such status if he maintains household for a dependent (not his spouse).

(j) Nonresident alien wife files a Form 1040NR if she has U.S. sourced income.

(k) If the spouses are living outside the U.S.A. the wife's share of the husbands' salary is sourced outside the U.S. and therefore not reportable by her (source of salary is where it is earned).

(1) She would report one half of the withholding on her husband's pay and claim refund of such amount.

#### Notes:

(1) Both taxpayers must submit statements establishing domiciles, residence status of wife, where the income is earned, etc.

(2) If wife has U.S. sourced income through community property law she must report it on 1040NR (i.e., dividends, interest, etc.).

## Quiz for Chapter 7

### Question—Answer Quiz

1. The following questions are asked by a Navy officer, a resident of New York, who is on duty in Japan. His taxable income for the taxable year is \$7,500. His wife, to whom he has been married for three years, is Japanese and has never visited the United States. She earned \$1,500 from employment in Tokyo, Japan during the taxable year.
  - a. Is he required to file a U.S. income tax return?
  - b. Is his wife required to file a U.S. income tax return?
  - c. If they had returned to Yonkers, N.Y., and became residents of that city on 1 November of the taxable year, how should they file? Separately, jointly, etc.?
2. Capt. George Wilson, a United States citizen, domiciled in Maryland, was stationed in Tokyo, Japan. On 12 Feb., he married a nonresident alien and he and his wife remained in Japan for the remainder of the year. His income was \$8,900.00. His wife had a \$3,000.00 salary earned in a Tokyo beauty shop. She was not the dependent of another and had no U.S. sourced income. The couple had no children or dependents.
  - a. What return would Capt. Wilson file?
  - b. Could he and his wife file a joint return?
  - c. What tax table would Capt. Wilson compute his tax under?
  - d. How many exemptions would he claim?
  - e. Would Mrs. Wilson file a federal income tax return, and, if so, which form?
3. Sgt. Smith, from California, marries Miss Kim on 1 June. From 1 January to 31 May, Sgt. Smith earned \$3,000. From 1 June to 31 December, while married, Smith earned \$5,000. Miss Kim's earnings were \$1,000 before marriage and \$1,500 after Sgt. Smith was in Korea the entire year.
  - a. Can Sgt. Smith file a joint return with Mrs. Smith?
  - b. What income does Sgt. Smith report on Form 1040?
  - c. Does Sgt. Smith have a choice of a standard deduction or itemized deduction?



## Chapter 8. Section 911—Exclusion of Earned Income From Sources Without the United States

Income from personal services rendered abroad by U.S. citizens up to stipulated maximum amounts is exempt from U.S. tax. However, U.S. citizens, who are U.S. Government Employees or members of the U.S. Armed Forces are not entitled to exclude compensation received from such government employment or from any of its agencies or instrumentalities. For these other U.S. citizens to qualify for exemption, they must meet either of the following circumstances:

(1) A bona fide resident of a foreign country, who has been such for an uninterrupted period that includes an entire taxable year, is exempt from tax on the first \$20,000 of wages earned abroad for a full tax year. If an individual has been a bona fide resident of a foreign country for an uninterrupted period of 3 consecutive years, this individual is allowed an exclusion of \$25,000 with respect to that portion of a taxable year occurring after the expiration of the three year period.

(2) An individual who has been physically present in a foreign country for at least 510 full days (approximately 17 months) out of 18 consecutive months is exempt from tax on the first \$20,000 of wages earned abroad for a full tax year. This limitation remains at \$20,000 regardless of the length of time the individual may be physically present in a foreign country.

These exemptions apply only to compensation received for personal services rendered abroad. They do not apply to investment income, capital gains, or compensation received for personal services rendered in the United States on a trip there; all such amounts are taxable.

The general rules pertaining to the exemption of earned income, under either of the two provisions above, are:

(1) Compensation for services performed outside the United States qualifies even if payment is received in the United States.

(2) To compute the applicable ceiling, the compensation received must be related to the year in which the services were performed, even though on the cash basis compensation is reportable or taxable only when received.

(3) No amount received more than one year after the end of the year in which the services were rendered is exempt.

(4) Amounts paid by the United States or any agency thereof are not exempt; thus, the pay received by a member of the armed services serving abroad is not excludable.

(5) Business expenses allocable to exempt earned income are not deductible.

### Bona Fide Residence

A bona fide resident of a foreign country is one who in fact has established a residence there for an indefinite period. If a person goes to a foreign country to work for an indefinite period and sets up permanent quarters there for himself and his family, this person probably

becomes a bona fide resident immediately upon so doing. Even though this person may have an intention to return to the United States at some indefinite time in the future, a person can still be a bona fide foreign resident. On the other hand, one who goes to a foreign country for a definite purpose that can be promptly accomplished is a transient.

There is no all-inclusive test or definition of bona fide foreign residence. In considering this issue in the many litigated cases, the courts have given much weight to the purpose of the trip abroad, intended and actual length of stay, whether the family accompanied the individual, type of quarters occupied, and participation in local social organizations. Once bona fide residence in a foreign country has been established, temporary visits to the United States or elsewhere on vacation or business trips will not interrupt the period of bona fide foreign residence. Abandonment of a foreign residence simultaneously with a trip to the United States preliminary to transfer to another foreign post may terminate a period of bona fide foreign residence.

An individual will not be considered to be a bona fide resident of a foreign country if he (1) makes a statement to the authorities of that country that he is not a resident thereof, (2) has earned income from a source within such country, and (3) the officials there hold him not subject to income tax as a resident of that country.

### Physical Presence Abroad

The other means of excluding from gross income compensation for personal services rendered abroad is for a U.S. citizen to be physically present in one or more foreign countries for at least 510 full days, approximately 17 months, during any period of 18 consecutive months. The rule is simple but very exacting: to qualify, an individual must be on foreign soil for the requisite time. His intentions of staying or returning, or the nature and purpose of the stay abroad are immaterial. Any 18 consecutive months may be considered to acquire 510 qualifying full days of physical presence in foreign countries.

A qualifying day means a period of 24 consecutive hours beginning at midnight and ending the following midnight. In computing the minimum of 510 full days of presence in foreign countries, all separate periods of such presence during the period of 18 consecutive months are to be totaled. If an individual travels from one place in a foreign country to another place in the same or in another foreign country over a route a portion of which is not within any country, and if the travel not within any country is less than 24 hours, the individual is considered within a foreign country during the period of that travel. Any day during which a person travels in or over the United States or its possessions may not be counted as a day of physical presence in a foreign country. The 510 full days need not be consecutive, but may be interrupted by periods during

which the citizen is not present in a foreign country. *Time spent in a foreign country in the employ of the United States Government will count toward satisfaction of the 510 full-days requirement, even though amounts paid by such Government are not excludable.*

Any period of 18 consecutive months during which an individual satisfies the 510 full days requirement, even though such period constitutes a part of a longer period of presence in a foreign country or countries, is permitted. Any period qualifies commencing with the beginning of any day of a calendar month and terminating with the close of the day which precedes that day in the eighteenth succeeding calendar month numerically corresponding to the day of the period's beginning. If there is no such corresponding day, the qualifying period closes with the last day of the eighteenth succeeding month. Such period need not commence with the day of arrival in a foreign country nor terminate with the day of departure. In no event may the 510 full-days requirement be reduced by being prorated over a period of less than 18 consecutive months.

Because of the preciseness of the physical-presence rule, a careful record of dates and times of travel, with appropriate documentary support, is important.

### First Year in a Foreign Country

Before a taxpayer can exclude personal service income on the grounds that he is a bona fide resident of a foreign country for an entire taxable year, or that he has been physically present in a foreign country for 510 full days out of an 18 month consecutive period, the taxable year or 18 month period must elapse. A calendar year basis taxpayer arriving in a foreign country on 30 September 1975 must file his income tax return for 1975 on or before 15 June 1976 (assuming he is outside the United States on 15 April 1976). However, on 15 June 1976 he is not in the position to state that he has been a bona fide resident of such foreign country for an entire taxable year (1 January 1976 through 31 December 1976) nor that he has been physically present in a foreign country 510 full days out of an 18 consecutive month period (1 October 1975 through 31 March 1977 if the taxpayer did not leave such country for the full 18 months). In such a situation, the taxpayer can follow one of two procedures.

(1) Include such personal service income earned abroad on his 1975 Form 1040 and subject it to Federal income tax. After 31 December 1975 or 31 March 1977 depending on his qualifying excludable status, he would file a claim for refund of the tax paid on such foreign sourced income, and submit a completed Form 2555 with his claim. He would be entitled to receive interest on his refund. A Form 1040X or 843 may be used in filing the claim for refund. Use of the Form 1040X is preferred.

(2) He should obtain an extension of time for filing his income tax return. He may obtain an extension by applying on Form 2350 to the Internal Revenue Service

Center, Philadelphia, Pa., or the local Revenue Service Representative or other Revenue Service employee. He must file Form 2350 before the date for filing his return. If he files on a calendar year basis this would be June 15. An extension granted will be to a date after the time requirements are satisfied.

If he applies for an extension on Form 2350, he should not file his income tax return with that form. This is because taxpayers who apply for an extension on Form 2350 ordinarily expect to pay no tax because they will qualify for exemption after they satisfy the requirements of the bona fide residence or physical presence tests. If he obtains an extension of time by use of such form, and because of unforeseen events he finds it impossible to satisfy the requirements of the above tests, he should file his income tax return as soon as possible, because interest must be paid on any tax due after the regular due date of the return (even though an extension was granted).

#### Notes:

(1) If the taxpayer will have tax to pay with his return (even after qualifying for the exclusion) it may be advisable for him to file by the due date of his return or 2 months later if he is abroad on the due date. The reason for this is that interest at the rate of 9 percent per annum is charged on the unpaid tax from the regular due date of the return to the date his tax is paid.

(2) In procedure (2) the taxpayer should attach his Form 2350 to his Form 1040 and submit it to the same internal revenue office where he sent his original Form 2350.

### Personal Service Earnings From Appropriated or Nonappropriated Funds

The exclusion from tax does not cover compensation received by U.S. citizens from either appropriated or nonappropriated fund organizations (U.S. Armed Forces exchanges, commissioned and noncommissioned officers' messes, armed forces motion picture services, and other organizations similarly organized and operated under U.S. Army, Navy, or Air Force regulations) in connection with the rendition of personal services abroad for such organizations. Appropriated or nonappropriated fund organizations are considered as integral parts of the armed forces, agencies, or instrumentalities of the U.S. Thus, compensation received from such organizations constitutes amounts paid by the U.S. or any of its agencies or instrumentalities. In view of this, U.S. recipients of such amounts may not exclude them from U.S. income taxation.

A detailed discussion of personal service income that is excludable because of a taxpayer's bona fide residence or physical presence in a foreign country has not been presented. Publication 54, Tax Guide for U.S. Citizens Abroad, should be consulted if a situation arises in which a taxpayer has such income.

# Appendix A: Quiz Solutions 1-7

## Solutions for Chapter 1

### Yes-No Solutions

- |        |        |
|--------|--------|
| A. No  | F. Yes |
| B. Yes | G. No  |
| C. Yes | H. Yes |
| D. Yes | I. No  |
| E. No  |        |

### True-False Solutions

1. F See chart for filing requirements.
2. F If the gross income of a single taxpayer under 65 is \$2,350 or more, he is required to file a tax return. If the gross income of a single taxpayer over 65 is \$3,100 or more he is required to file a tax return.
3. F Gross income is FMV of \$1,350 in this case (less than \$2,350 required for filing).
4. T For joint return purposes they are married as of the last day of the taxable year.
5. T Sue earned less than \$750.
6. F Since Jim is remarried he cannot file jointly with Sue.
7. F He must file since he had unearned income.
8. T
9. F Automatic extension is 2 months to 15 June for calendar year taxpayers.
10. F 15 April 1976 (3 years from filing or due date which ever is later).

### Multiple Choice Solutions

1. A. Gross income. See detailed outline in summary for filing requirements.
2. D. Over 65 with gross income of less than \$3,100. All others must file because they meet the gross income test.
3. C. If a husband and wife have separate gross incomes, they may file separate returns or a joint return. If a joint return is filed, all income of each spouse must be included therein even though the income of one is less than \$750 and he would not otherwise be required to file a separate return. Under no circumstances may one file a separate return to receive a refund of tax withheld on wages and then file a joint return with the other spouse.
4. B. By remarrying before the end of the year, he cannot file jointly with the deceased wife but can so file with present wife. None of the others are permissible.
5. B. It would ordinarily be to their advantage to file separate returns. A smaller adjusted gross income allows a greater medical deduction.
6. D. False. 15 April (due date is later than filing date).

## Question-Answer Solutions

1. a. Yes b. No c. Yes
2. a. No  
b. Yes. By filing a return Form 1040 or Form 1040A, showing the overpayment and requesting the refund.
3. a. Internal Revenue Service Center  
1160 West 1200 South St.  
Ogden, Utah 84201  
b. Internal Revenue Service Center  
4800 Buford Highway  
Chamblee, Georgia 30006  
c. Internal Revenue Service Center  
11601 Roosevelt Boulevard  
Philadelphia, Pennsylvania 19155
4. a. No b. No

## Solutions for Chapter 2

### Question-Answer Solutions

1. a. Personal exemption \$750 for the taxpayer and, if he files a separate return, \$750 for his spouse provided she had no income and was not a dependent of another taxpayer. Additional \$750 if the spouse is 65 or over and \$750 if the spouse is blind. For each other qualified dependent \$750.

b. Personal exemption of \$1500 (\$750 each). Additional \$750 is allowable if wife is 65 or over and/or \$750 if wife is blind. For each other qualified dependent \$750.

2. If not totally blind, attach to return a certificate from a physician skilled in the diseases of the eye or a registered optometrist, showing central visual acuity does not exceed 20/200 in the better eye with corrective lenses or that widest diameter of the visual field subtends an angle no greater than 20 degrees.

3. *Support test*—the taxpayer is required to have contributed more than 50% of the support of the dependent for the calendar year.

*Gross income test*—generally, a taxpayer is not entitled to an exemption for a dependent who received gross income of \$750 or more for the calendar year.

*Member-of-household or relationship test*—an exemption may be claimed for a dependent related to the taxpayer, or is a member of the taxpayer's household and lives with the taxpayer for the entire year.

*Citizenship test*—generally, a dependent must be a citizen, or national or resident of the United States, or a resident of Canada, Mexico, the Canal Zone or the Republic of Panama.

*Joint-return test*—generally, if a joint return is made by the taxpayer and his spouse, no other person is allowed an exemption for such spouse even though the other person would have been entitled to claim an exemption for such spouse as a dependent if such joint return had not been made.

4. a. Yes  
b. If a dependent otherwise qualifies, he may have

gross income of \$750 or more and still be a dependent if he is the taxpayers' child and (a) is a full-time student, or (b) has not reached the age of 19 by the close of the taxable year.

5. Yes, if a legally adopted child was a member of the citizen taxpayer's household, there is an exception to the rule requiring that a dependent must be a United States citizen, national or a resident of the United States, Canal Zone, Panama or a country contiguous to the United States. The exception applies to a citizen taxpayer's legally adopted child whose principal place of abode is the home of the taxpayer and is a member of that household during the entire taxable year. The exception applies if the alien child is a member of the household for the entire year even though the child is adopted during the taxable year. That is, the child must be a member of the household for the entire year but the parent-child relationship need only exist at the end of the year.

Where the dependent child is a resident of the United States, it is immaterial that the child was not a member of taxpayer's household during the entire taxable year. If legally adopted and not a resident of the United States the dependent child and taxpayer must occupy same household for entire taxable year.

6. The term "support" includes expenditures for food, shelter, clothing, medical and dental care, education, and the like.

7. Yes. The Government contribution is nontaxable "basic allowance for quarters."

8. No. A taxpayer's spouse does not meet the relationship test. Yet a \$750 exemption is available to the taxpayer if he files a separate return and his spouse has no gross income and is not the dependent of another taxpayer. There is no requirement that the spouse be a resident or citizen of the United States nor that she resides with the taxpayer as a member of his household.

9. a. No. Mrs. Briggs' sister was neither a citizen nor a resident of the United States nor a resident of Canada, Mexico, the Canal Zone or Panama at any time during the taxable year.

b. Same as in "a". Must be a resident of the Canal Zone, Panama, Mexico or Canada.

10. a. No. Since Jane filed a joint return with her husband, her father may not claim her as a dependent for that year even though he met all the other requirements for claiming her as a dependent.

b. No. On a separate return, you may claim an exemption for your wife only if she had no gross income and was not the dependent of another taxpayer.

11. Major Albeer may claim a dependency exemption for each of his children. The son qualifies as a dependent inasmuch as he was a student for over five months.

The daughter was under 19 years of age, a student for over five months, and did not have gross income of \$750, or more.

12. a. Yes. The requirements have been satisfied in that (1) no one person contributed over half of the support, (2) Colonel Howard, Betsy, and Andrew contributed more than 50% of the parents' support, (3) the Colonel contributed more than 10% of the total, (4) Betsy and Andrew signed a written agreement that they would not claim the dependency exemptions.

b. Colonel Howard, Betsy or Andrew (multiple support agreement necessary).

13. a. Yes. Although a citizen of the United States whose spouse is a nonresident alien may not file a joint return with such spouse, he may, provided she has no gross income subject to Federal income tax and was not a dependent of another taxpayer, claim an exemption for her on his separate return, regardless of her nationality or place of residence.

b. Yes. Mrs. Thompson's income was not from sources within the United States.

c. No. No joint return shall be made if either the husband or wife at any time during the taxable year is a nonresident alien.

14. a. Either W/O Jones, his sister, or the widow may claim an exemption for the mother providing each other person in the group files a written declaration that he or she will not claim the individual as a dependent for any taxable year beginning in such calendar year.

b. Yes. The written declaration required may be made on Form 2120. Any declaration made other than on Form 2120 shall conform to the substance of Form 2120.

c. Each other person in the group not claiming the exemption.

### Support Test Problem

1. Mother
2. Father
3. Mother

### Tax Computation Problems

	Tax
a. ....	\$ 682
b. ....	\$ 790
c. ....	\$ 607
d. ....	\$ 486
e. ....	\$ 395
f. ....	\$ 900
g. ....	\$1,791
h. ....	\$2,187



**Short Form 1040A U.S. Individual Income Tax Return** Department of the Treasury Internal Revenue Service **1975**

Name (If joint return, give first names and initials of both) **Joseph P** Last name **BROWN**  
 Present home address (Number and street, including apartment number, or rural route) **2000 MAIN STREET**  
 City, town or post office, State and ZIP code **ROCKVILLE MARYLAND 20850**  
 Occupation **U.S. ARMY**  
 Your social security number **153 23 6389** For Privacy Act Notification, see page 2 of Instructions.  
 Spouse's social security no. For IRS use only

**Requested by** **Rockville** **A** In what city, town, village, etc., do you live?  
**Rockville** **B** Do you live within the legal limits of the city, town, etc.?  
**Yes** **Rockville** **C** In what county and State do you live?  
**Montgomery** **Md** **Rockville** **D** In what township do you live? (See page 5.)

**Filing Status**  
 1  Single (check only ONE box)  
 2  Married filing joint return (even if only one had income)  
 3  Married filing separately. If spouse is also filing give spouse's social security number in designated space above and enter full name here  
 4  Unmarried Head of Household (See page 4 of Instructions)  
 5  Qualifying widow(er) with dependent child (Year spouse died **19**). See page 4 of Instructions.  
 6a  Regular  Spouse Enter number of boxes checked **1**  
 b First names of your dependent children who lived with you Enter number **1**  
 c Number of other dependents (from line 22) **1**  
 d Total (add lines 6a, b, and c) **1**  
 e Age 65 or over  Yourself  Spouse Enter number of boxes checked  
 Blind  Yourself  Spouse  
 7 Total (add lines 6d and e) **1**

8 Presidential Election  Do you wish to designate \$1 of your taxes for this fund?  
 Campaign Fund  if joint return, does your spouse wish to designate \$1?  
 (Attach Forms W-2 if available, see page 6 of Instructions)  
 9 Wages, salaries, tips, and other employee compensation **6263**  
 10a Dividends (if over \$400, see Instruc) **63** 10b Less exclusion **Balance**  
 11 Interest income (if over \$400, see Instructions at top of page 3) **315**  
 12 Total (add lines 9, 10c, and 11) (Adjusted Gross Income) **6478**  
 Note: If you check the "Yes" boxes, it will net increase your tax or reduce your refund.

Attach Copy of Money Order here and Check or Money Order here  
 If you want IRS to figure your tax, see page 6 of Instructions.  
 If line 12 is under \$15,000, find tax in Tax Tables (on pages 8-18) and enter on line 13a, on the back.  
 If line 12 is \$15,000 or more, figure your tax using the Tax Computation Worksheet on page 18 of Instructions.



Form 1040A (1975)

13a Tax, check if from:  Tax Tables (pages 8-18) OR  Tax Computation Worksheet (page 18)

b Credit for personal exemptions (multiply line 6d by \$30)

14a Balance (subtract line 13b from line 13a). If less than zero, enter zero.

b Credit for contributions to candidates for public office (see page 7 of Instructions)

15 Income tax (subtract line 14b from line 14a). If less than zero, enter zero.

16a Total Federal income tax withheld (attach Forms W-2 to front)

b Excess FICA, RRTA, or FICA/RRITA tax withheld (see page 7 of Instructions)

c 1975 estimated tax payments (include amount allowed as credit from 1974 return)

d Earned income credit

16a	816
b	
c	
d	

13a	716
b	30
14a	686
b	
15	686

Pay amount on line 18 in full with this return. Write social security number on check or money order and make payable to Internal Revenue Service

17	816
18	
19	130
20	130

17 Total (add lines 16a, b, c, and d)

18 If line 15 is larger than line 17, enter BALANCE DUE IRS

19 If line 17 is larger than line 15, enter amount OVERPAID

20 Amount of line 19 to be REFUNDED TO YOU

21 Amount of line 19 to be credited on 1976 estimated tax

If all of overpayment (line 19) is to be refunded, there is no entry on line 21

(a) NAME

(b) Relationship

(c) Months lived in your home, if born or died during year, write B or D

(d) Did dependent have income of \$750 or more?

(e) Amount furnished for dependent if 100% write ALL

(f) Amount furnished by OTHERS including dependent

\$

\$

\$

\$

22 Total number of dependents listed in column (a). Enter here and on line 6c

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge

Sign here

*Joseph S. DeWitt*  
Date 3/24/76

Preparer's signature (other than taxpayer)

Date

Spouse's signature (if filing jointly, BOTH must sign even if only one had income)

Address (and ZIP Code)

## Solutions for Chapter 3

### Multiple-Choice Solutions

1. D. Unrealized increase in value of property. All items are included in gross income.
2. E. \$5,875. All of the above items are includible in gross income.
3. E. \$1,700. All of the items are includible in gross income.
4. A. \$800.  $4 \times \$2 \times 100$  shares. The assignment of income does not relieve the assignor of the federal tax thereon.
5. A. \$150.00 in 1974 and \$304.50 in 1975. Interest is included in gross income in the year it is credited to his account.
6. D. \$500. Only Car Motor Co. dividends of \$400 and U.S. Talk Co. dividends of \$100 qualify as dividends.
7. D. Cash dividends paid by a mutual insurance company.
8. C. \$2,400. \$3,300 less \$900 specified for child support. The \$500 received for medical bills is not includible because it was not required under the decree.

### True-False Solutions

- |          |       |
|----------|-------|
| 1        | 2     |
| (a)—C    | (a)—F |
| (b)—C    | (b)—T |
| (c)—N.C. | (c)—F |
| (d)—C    | (d)—T |
| (e)—N.C. | 3—T   |
| (f)—N.C. | 4—F   |
| (g)—C    | 5—F   |
| (h)—N.C. |       |
| (i)—C    |       |
| (j)—N.C. |       |
| (k)—N.C. |       |
| (l)—N.C. |       |

## Solutions for Chapter 4

### True-False Solutions

- |         |            |
|---------|------------|
| 1. T    |            |
| 2. F    |            |
| 3. T    |            |
| 4. T    |            |
| 5. a. F | 5. (cont.) |
| b. T    | f. T       |
| c. F    | g. F       |
| d. F    | h. T       |
| e. T    | i. T       |
| 6. T    |            |

### Multiple Choice Solutions

1. B. The value of property acquired in exchange for services performed.
2. E. All of the above.

3. B. Thirty-first day of absence.
4. E. None of the above.
5. C. Military retirement, based on length of service.

### Question-Answer Solutions

1. Yes He can exclude an entire month's pay for every month during a part of which he spends in hospital. He cannot claim an extension for filing his return based upon service in a combat zone, followed by hospitalization as the result of such service if the hospitalization is in the United States. He would have to file on or by 15 April.
2. No. Compensation for personal injury is not includible in gross income.
 

3. a. Reimbursement .....	\$175
Less actual expense .....	150
Includible in income .....	<u>\$ 25</u>
b. Reimbursement .....	<u>\$500</u>
Expenses .....	650
Excess over reimbursement .....	<u>\$150</u>
Not deductible (maid) .....	20
Deductible .....	<u><u>\$130</u></u>
- c. Reimbursement of \$380 is includible in gross income. Movement of dependents is a qualifying moving expense and \$275 is therefore deductible as a moving expense.
4. At least 71 miles.
5. Generally, at least 39 weeks in the 12-month period following his arrival.

## Solutions for Chapter 5

### True-False Solutions

1. T
2. D
3. N.D.
4. D
5. N.D.
6. N.D.
7. D
8. T

### Multiple Choice Solutions

1. e.
2. e. All personal nondeductible expenses.
3. c. \$240 Property taxes on residence ..... \$105  
     State income tax ..... 110  
     State gasoline tax ..... 25  
     Total allowable ..... \$240
4. e. None. Mislaid or lost property is not a theft and therefore not deductible.
5. e. None. Termite damage is not sudden enough to qualify as a casualty loss.
6. b. Not a recognized charitable organization.

### Question-Answer Solutions

1. a. For 1975, the use of the standard deduction is limited as follows:

16% of adjusted gross income up to \$2,300 in the case of single persons and \$2,600 in the case of married individuals. The limitation is \$1,300 in the case of married persons filing separate returns.

b. No. If the standard deduction is taken, tax credit for taxes of foreign countries shall not be allowed.

c. No. The deduction of the spouse who itemizes is controlling. The other spouse must also itemize deductions, even though they amount to less than the standard deductions.

2. a. None. It is a donation to an organization not created in the U.S. or any state therein.

b. \$550, the fair market value of the stock at the date of gift.

c. None. Same as 2(a) above.

d. None. This is a contribution of a service to a private individual.

e. \$52. This is considered a gift to an arm of the U.S. exclusively for public purposes.

f. \$22.40 (7¢ per mile  $\times$  320 miles). Unreimbursed expenditure for the use of the car for the benefit of a qualified organization is deductible.

3. a. Not deductible.

b. Deductible.

c. Deductible.

d. Not deductible.

e. Not deductible.

f. Deductible (\$5).

4. a. No. Taxes are deductible only by the person upon whom they are imposed. They are thus deductible by the owner of the property, not the holder of the mortgage.

5. a. Nondeductible.

b. Nondeductible.

c. Deductible.

d. Deductible.

e. Nondeductible.

f. Deductible.

## Solutions for Chapter 7

### Question—Answer Solutions

1. a. Yes.

b. No.

c. Separately. Under those conditions the wife would have become a resident alien on 1 November. She must be a resident alien for the entire year before a joint return may be filed.

2. a. Form 1040.

b. No.

c. Married filing separate.

d. Two.

e. No.

3. a. No.

b. \$6,250. All of his earnings before marriage (\$3,000) and one-half of his earnings after marriage (\$2,500) plus one-half of his wife's earnings after marriage (\$750.00).

c. Yes.

Solution to Continuing Problem (Chapters 3, 5 and 6)

Form

1040

US

Department of the Treasury—Internal Revenue Service  
Individual Income Tax Return

1975

For the year January 1–December 31 1975 or other taxable year beginning

1975, ending

19

Please print or type	Name (If joint return, give first names and initials of both) <b>John A. &amp; Betty</b>	Last name <b>Markat</b>	Your social security number <b>218 36 5387</b>	For Privacy Act Notification, see page 2 of instructions.
	Present home address (Number and street, including apartment number, or rural route) <b>22 Greenhill Avenue</b>		Spouse's social security no. <b>218 42 3678</b>	
	City, town or post office, State and ZIP code <b>Oxon Hill, Maryland 20021</b>		Occupation Yours <b>U.S.A.F.</b>	For IRS use only
			Spouse's <b>Secretary</b>	<input type="checkbox"/>

Requested by Census Bureau for Revenue Sharing	A In what city, town, village, etc. do you live? <b>Oxon Hill</b>	B Do you live within the legal limits of the city, town, etc? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Don't know	C In what county and State do you live? County <b>Prince George's</b> State <b>Maryl.</b>	D In what township do you live? (See page 4)
--	--	---	--	--

Filing Status	1 <input type="checkbox"/> Single (check only ONE box)	Exemptions	6a Regular <input checked="" type="checkbox"/> Yourself <input checked="" type="checkbox"/> Spouse	Enter number of boxes checked <b>2</b>
	2 <input checked="" type="checkbox"/> Married filing joint return (even if only one had income)		b First names of your dependent children who lived with you <b>Ann</b>	Enter number <b>1</b>
	3 <input type="checkbox"/> Married filing separately. If spouse is also filing, give spouse's social security number in designated space above and enter full name here		c Number of other dependents (from line 27)	<b>3</b>
	4 <input type="checkbox"/> Unmarried Head of Household (See page 5 of instructions)		d Total (add lines 6a, b, and c)	<b>3</b>
	5 <input type="checkbox"/> Qualifying widow(er) with dependent child (Year spouse died <b>19</b> ) See page 5 of instructions		e Age 65 or over <input type="checkbox"/> Yourself <input type="checkbox"/> Spouse	Enter number of boxes checked
			f Blind <input type="checkbox"/> Yourself <input type="checkbox"/> Spouse	
			7 Total (add lines 6d and e)	<b>3</b>

8 Presidential Election Campaign Fund Do you wish to designate \$1 of your taxes for this fund?  Yes  No  
If joint return, does your spouse wish to designate \$1?  Yes  No

Income	9 Wages, salaries, tips, and other employee compensation (Attach Forms W-2 if available, see page 3 of instructions)	9	<b>13,348</b>	<b>00</b>
	10a Dividends (See pages 7 and 8 of instructions) \$ <b>461.</b>	10c	<b>261</b>	<b>00</b>
	10b Less exclusion \$ <b>200.</b> Balance ▶			
	11 Interest income. [ If \$400 or less, enter total without listing in Schedule B. If over \$400, enter total and list in Part II of Schedule B ]	11	<b>200</b>	<b>00</b>
	12 Income other than wages, dividends, and interest (from line 36)	12	<b>1,687</b>	<b>50</b>
	13 Total (add lines 9, 10c, 11, and 12)	13	<b>15,496</b>	<b>50</b>
	14 Adjustments to income (such as "sick pay," moving expenses, etc. from line 42)	14		
15 Subtract line 14 from line 13 (Adjusted Gross Income) (If less than \$8,000, see page 8 of instructions on Earned Income Credit)	15	<b>15,496</b>	<b>50</b>	

- If you do not itemize deductions and line 15 is under \$15,000, find tax in Tables and enter on line 16a.
- If you itemize deductions or line 15 is \$15,000 or more, go to line 43 to figure tax.
- CAUTION If you have unearned income and can be claimed as a dependent on your parent's return, check here  and see page 7 of instructions

Tax, Payments and Credits	16a Tax, check if from <input type="checkbox"/> Tax Tables <input checked="" type="checkbox"/> Tax Rate Schedule X, Y, or Z	16a	<b>1,904</b>	<b>37</b>
	<input type="checkbox"/> Schedule D <input type="checkbox"/> Schedule G OR <input type="checkbox"/> Form 4726	b	<b>90</b>	<b>00</b>
	b Credit for personal exemptions (multiply line 6d by \$30)	c	<b>1,814</b>	<b>37</b>
	c Balance (subtract line 16b from line 16a)	17		
	17 Credits (from line 54)	18	<b>1,814</b>	<b>37</b>
	18 Balance (subtract line 17 from line 16c)	19		
	19 Other taxes (from line 63)	20	<b>1,814</b>	<b>37</b>
20 Total (add lines 18 and 19)				

Balance Due or Refund	21a Total federal income tax withheld (attach Forms W-2 or W-2P to front) (include amount allowed as credit from 1974 return)	21a	<b>1,982</b>	<b>00</b>
	b 1975 estimated tax payments	b		
	c Earned income credit	c		
	d Amount paid with Form 4868	d		
	e Other payments (from line 67)	e		
22 Total (add lines 21a through e)	22	<b>1,982</b>	<b>00</b>	

Balance Due or Refund	23 If line 20 is larger than line 22, enter BALANCE DUE IRS. (See page 8 of instructions)	23		
	24 If line 22 is larger than line 20, enter amount OVERPAID	24	<b>167</b>	<b>63</b>
	25 Amount of line 24 to be REFUNDED TO YOU	25	<b>167</b>	<b>63</b>
	26 Amount of line 24 to be credited on 1976 estimated tax ▶ 26			

If all of overpayment (line 24) is to be refunded (line 25), make no entry on line 26

Under penalties of perjury I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign here **John A. Markat** Date **4/6/76**  
 You, Taxpayer **Betty Markat** Date  
 Spouse's signature (if filing jointly BOTH must sign even if only one had income)

Preparer's signature (other than taxpayer) \_\_\_\_\_ Date \_\_\_\_\_  
 Address (and ZIP Code) \_\_\_\_\_

Solution to Continuing Problem (Cont. 1)

Form 1040 (1975)

Other Dependents	(a) NAME	(b) Relationship	(c) Months lived in your home, if born or died during year, write B or D	(d) Did dependant have income of \$750 or more?	(e) Amount YOU furnished for dependent's support. If 100% write ALL.	(f) Amount furnished by OTHERS including dependent.
						\$

27 Total number of dependents listed in column (a) Enter here and on line 6c

**Part I Income other than Wages, Dividends, and Interest**

28	Business income or (loss) (attach Schedule C)	28		
29a	Net gain or (loss) from sale or exchange of capital assets (attach Schedule D)	29a	857	50
29b	50% of capital gain distributions (not reported on Schedule D—see page 9 of Instructions)	29b		
30	Net gain or (loss) from Supplemental Schedule of Gains and Losses (attach Form 4797)	30		
31a	Pensions, annuities, rents, royalties, partnerships, estates or trusts, etc. (attach Schedule E)	31a	830	00
31b	Fully taxable pensions and annuities (not reported on Schedule E—see page 9 of Instructions)	31b		
32	Farm income or (loss) (attach Schedule F)	32		
33	State income tax refunds (does not apply if refund is for year in which you took the standard deduction—others see page 9 of Instructions)	33		
34	Alimony received	34		
35	Other (state nature and source—See page 9 of Instructions)	35		
36	Total (add lines 28 through 35) Enter here and on line 12	36	1,687	50

**Part II Adjustments to Income**

37	"Sick pay." (attach Form 2440 or other required statement)	37		
38	Moving expense (attach Form 3903)	38		
39	Employee business expense (attach Form 2106 or statement)	39		
40a	Payments to a Keogh (H.R. 10) retirement plan	40a		
40b	Payments to an individual retirement arrangement from attached Form 5329, Part III	40b		
41	Forfeited interest penalty for premature withdrawal—see page 10 of Instructions	41		
42	Total (add lines 37 through 41) Enter here and on line 14	42		

**Part III Tax Computation (Do not use this part if you use the Tax Tables to find your tax.)**

43	Adjusted gross income (from line 15)	43	15,496	50
44	(a) If you itemize deductions, check here <input type="checkbox"/> and enter total from Schedule A, line 41 and attach Schedule A	44	2,863	00
	(b) If you do not itemize deductions and line 15 is \$15,000 or more, check here <input type="checkbox"/> and: if box on line 2 or 5 is checked, enter 16% of line 15 but not more than \$2,600, if box on line 1 or 4 is checked, enter \$2,300; if box on line 3 is checked, enter \$1,300			
45	Subtract line 44 from line 43	45	12,633	50
46	Multiply total number of exemptions claimed on line 7, by \$750.	46	2,250	00
47	Taxable income. Subtract line 46 from line 45	47	10,383	50

(Figure your tax on the amount on line 47 by using Tax Rate Schedule X, Y, or Z, or if applicable, the alternative tax from Schedule D, income averaging from Schedule G, or maximum tax from Form 4726.) Enter tax on line 16a.

Part IV Credits	48	Retirement income credit (attach Schedule R)	48		
	49	Investment credit (attach Form 3468)	49		
	50	Foreign tax credit (attach Form 1116)	50		
	51	Contributions to candidates for public office credit—see page 10 of Instructions	51		
	52	Work Incentive (WIN) credit (attach Form 4874)	52		
	53	Purchase of new principal residence credit (attach Form 5405)	53		
	54	Total (add lines 48 through 53) Enter here and on line 17	54		

Part V Other Taxes	55	Tax from recomputing prior year investment credit (attach Form 4255)	55		
	56	Tax from recomputing prior-year Work Incentive (WIN) credit (attach Schedule)	56		
	57	Minimum tax Check here <input type="checkbox"/> , if Form 4625 is attached	57		
	58	Tax on premature distributions from attached Form 5329, Part V	58		
	59	Self employment tax (attach Schedule SE)	59		
	60	Social security tax on tip income not reported to employer (attach Form 4137)	60		
	61	Uncollected employee social security tax on tips (from Forms W-2)	61		
62	Excess contribution tax from attached Form 5329, Part IV	62			
63	Total (add lines 55 through 62) Enter here and on line 19	63			

**Part VI Other Payments**

64	Excess FICA, RRTA, or FICA/RRTA tax withheld (two or more employers—see page 10 of Instructions)	64		
65	Credit for federal tax on special fuels, nonhighway gasoline and lubricating oil (attach Form 4136)	65		
66	Credit from a Regulated Investment Company (attach Form 2439)	66		
67	Total (add lines 64 through 66) Enter here and on line 21e	67		



**Schedules A & B—Itemized Deductions AND Dividend and Interest Income**

(Form 1040)  
Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040)

**1975**

Name(s) as shown on Form 1040

*John A. + Betty Manhat*

Your social security number

*218 36 5387*

**Schedule A—Itemized Deductions (Schedule B on back)**

Medical and Dental Expenses (not compensated by insurance or otherwise) (See page 11 of Instructions.)		Contributions (See page 12 of Instructions for examples)	
1 One half (but not more than \$150) of insurance premiums for medical care. (Be sure to include in line 10 below)		21 a Cash contributions for which you have receipts, cancelled checks or other written evidence	250 00
2 Medicine and drugs		b Other cash contributions. List donees and amounts. ▶	
3 Enter 1% of line 15, Form 1040		<i>U.S.A.F. Base Chapel</i>	40 00
4 Subtract line 3 from line 2. Enter difference (if less than zero, enter zero)		22 Other than cash (see page 12 of instructions for required statement)	
5 Enter balance of insurance premiums for medical care not entered on line 1		23 Carryover from prior years	
6 Enter other medical and dental expenses:		24 Total contributions (add lines 21a through 23). Enter here and on line 38 ▶	290 00
a Doctors, dentists, nurses, etc.		<b>Casualty or Theft Loss(es)</b> (See page 13 of Instructions) Note: If you had more than one loss, omit lines 25 through 28 and see page 13 of Instructions for guidance.	
b Hospitals		25 Loss before insurance reimbursement	1,300 00
c Other (itemize—include hearing aids, dentures, eyeglasses, transportation, etc.) ▶		26 Insurance reimbursement	500 00
		27 Subtract line 26 from line 25. Enter difference (if less than zero, enter zero)	800 00
		28 Enter \$100 or amount on line 27, whichever is smaller	100 00
7 Total (add lines 4 through 6c)		29 Casualty or theft loss (subtract line 28 from line 27). Enter here and on line 39 ▶	700 00
8 Enter 3% of line 15, Form 1040		<b>Miscellaneous Deductions</b> (See page 13 of Instructions)	
9 Subtract line 8 from line 7 (if less than zero, enter zero)		30 Alimony paid	600 00
10 Total (add lines 1 and 9). Enter here and on line 35 ▶		31 Union dues	
<b>Taxes</b> (See page 11 of Instructions)		32 Expenses for child and dependent care services (attach Form 2441)	520 00
11 State and local income	500 00	33 Other (itemize) ▶	
12 Real estate		<i>Insignia for uniform</i>	12 00
13 State and local gasoline (see gas tax tables)	31 00		
14 General sales (see sales tax tables)	155 00	34 Total (add lines 30 through 33). Enter here and on line 40 ▶	1,132 00
15 Personal property		<b>Summary of Itemized Deductions</b>	
16 Other (itemize) ▶		35 Total medical and dental—line 10	
		36 Total taxes—line 17	686 00
17 Total (add lines 11 through 16). Enter here and on line 36 ▶	686 00	37 Total interest—line 20	55 00
<b>Interest Expense</b> (See page 12 of Instructions.)		38 Total contributions—line 24	290 00
18 Home mortgage		39 Casualty or theft loss(es)—line 29	700 00
19 Other (itemize) ▶		40 Total miscellaneous—line 34	1,132 00
<i>1st Nat'l Bank</i>	48 00	41 Total deductions (add lines 35 through 40). Enter here and on Form 1040, line 44 ▶	2,863 00
<i>Department Stores</i>	7 00		
20 Total (add lines 18 and 19). Enter here and on line 37 ▶	55 00		

**A**



Solution to Continuing Problem (Cont. 4)

SCHEDULE D (Form 1040)

Capital Gains and Losses (Examples of property to be reported on this Schedule are gains and losses on stocks, bonds, and similar investments, and gains (but not losses) on personal assets such as a home or jewelry.)

Department of the Treasury Internal Revenue Service

1975

Name(s) as shown on Form 1040

Social security number

John A + Betty Mankat

218 36 5387

Part I Short-term Capital Gains and Losses—Assets Held Not More Than 6 Months

D

Table with 6 columns: a. Kind of property and description, b. Date acquired, c. Date sold, d. Gross sales price, e. Cost or other basis, f. Gain or (loss). Includes summary rows 2 through 5.

Part II Long-term Capital Gains and Losses—Assets Held More Than 6 Months

Table with 6 columns: a. Kind of property and description, b. Date acquired, c. Date sold, d. Gross sales price, e. Cost or other basis, f. Gain or (loss). Includes summary rows 7 through 13.

Part III Summary of Parts I and II

Summary table with 3 columns: line number, gain/loss amount, and tax limit. Includes rows 14 through 16.

# Schedules E&R—Supplemental Income Schedule AND Retirement Income Credit Computation

(Form 1040)

1975

Department of the Treasury  
Internal Revenue Service

(From pensions and annuities, rents and royalties, partnerships, estates and trusts, etc.)  
▶ Attach to Form 1040. ▶ See Instructions for Schedules E and R (Form 1040).

Name(s) as shown on Form 1040: John A. + Betty Mankat Your social security number: 218 36 5387

Schedule E—Supplemental Income Schedule (Complete Schedule R on back if eligible for retirement income credit)

**Part I Pension and Annuity Income.** If fully taxable, do not complete this part. Enter amount on Form 1040, line 31b. For one pension or annuity not fully taxable, complete this part. If you have more than one pension or annuity that is not fully taxable, attach a schedule and enter combined total of taxable portions on line 5.

1 Name of payer

2 Did your employer contribute part of the cost?  Yes  No  
If "Yes," is your contribution recoverable within 3 years of the annuity starting date?  Yes  No  
If "Yes," show: Your contribution \$ \_\_\_\_\_, Contribution recovered in prior years \$ \_\_\_\_\_

3 Amount received this year

4 Amount excludable this year

5 Taxable portion (subtract line 4 from line 3)

**Part II Rent and Royalty Income.** If you need more space, you may use Form 4831.  
Note: If you are reporting farm rental income here, see Schedule E Instructions to determine if you should also file Form 4835. If at least two thirds of your gross income is from farming or fishing, check this box .

(a) Kind and location of property If residential, also write "R"	(b) Total amount of rents	(c) Total amount of royalties	(d) Depreciation (explain below) or depletion (attach computation)	(e) Other expenses (Repair, etc. explain below)	
Wood + Brick House 1012 Main St. Dallas, Texas (R)	2,400.00		500.00	1,070.00	
1 Totals	2,400.00		500.00	1,070.00	
2 Net income or (loss) from rents and royalties (column (b) plus column (c) less columns (d) and (e))					830 00

**Part III Income or Losses from Partnerships, Estates or Trusts, Small Business Corporations.**  
Note: If any of the partnership, estate or trust income reported below is from farming or fishing, see Schedule E Instructions to determine if you should also file Form 4835. If at least two-thirds of your gross income is from farming or fishing, check this box .

(a) Name	(b) Enter in column (b) P for Partnership, E for Estate or Trust, or S for Small Business Corporation	(c) Employer identification number	(d) Income or (loss)	(e) Additional 1st year depreciation (applicable only to partnerships)	
1 Totals					
2 Income or (loss) Total of column (d) less total of column (e)					

TOTAL OF PARTS I, II, AND III (Enter here and on Form 1040, line 31a) **830 00**

Explanation of Column (e), Part II

Item	Amount	Item	Amount
Interest	500.00		
Real Estate Tax	400.00		
Insurance	50.00		
Realtor Fee	120.00		

Schedule for Depreciation Claimed in Part II Above. If you need more space or you computed depreciation under the Class Life (ADR) System or Guideline Class Life System, use Form 4562.

(a) Description of property	(b) Date acquired	(c) Cost or other basis	(d) Depreciation allowed or allowable in prior years	(e) Method of computing depreciation	(f) Life or rate	(g) Depreciation for this year <b>E</b>
1 Total additional first-year depreciation (do not include in items below)						
Wood + Brick House	12/12/67	20,000.00	1,000.00	S/L	40 yrs	500.00
2 Totals						500.00

**1040X**  
(Rev. August 1975)

**Amended U.S. Individual  
Income Tax Return**

Department of the Treasury  
Internal Revenue Service

Please answer all questions, fill in applicable items, and explain changes on page 2.

Please print or type	Name and initial (If joint return, give first names and middle initials of both) <b>John A. &amp; Betty</b>	Last name <b>Markat</b>	Your social security number <b>218-36-5387</b>
	Present home address (Number and street, including apartment number, or rural route) <b>22 Greenhill Avenue</b>		Spouse's social security no. <b>218-42-3678</b>
	City, town or post office, State, and ZIP code <b>Oxon Hill, Maryland 20031</b>		

Enter below name and address used on original return (if same as above, write "Same") If changing from separate to joint return, enter names and addresses used on original returns. (Note: You cannot change from joint to separate returns after the due date has passed for filing separate returns.)

a. This return is for calendar year **1975**. If not for calendar year, give ending date of fiscal year **19**

b. Office where original return was filed? **Phila. Service Center** c. Has the Internal Revenue Service advised you that your original return is being or will be examined?  Yes  No. If "Yes," identify office ▶

d. Filing status claimed:  
On original return ▶  Single  Married filing jointly  Married filing separately  Unmarried Head of Household  Qualifying Widow(er)  
On this return . . . ▶  Single  Married filing jointly  Married filing separately  Unmarried Head of Household  Qualifying Widow(er)

Income and Deductions					A. As originally reported or as adjusted (See Specific Instructions)	B. Net change (Increase or Decrease—explain on page 2)	C. Correct amount	
1	Total income (adjusted gross income):	1972	1973	1974	1975			
	Form 1040, line . . . . .	17	15	15	15	15,496.50	15,496.50	
	Form 1040A, line . . . . .	14	12	12	12			
2	Deductions. See instructions and explain any changes on page 2							2,863.00
<b>Tax Liability</b>								
3a	Tax:	1972	1973	1974	1975			
	Form 1040, line . . . . .	18	16	16	16a	1,904.37	88.00	1,816.37
	Form 1040A, line . . . . .	19	17	17	13a			
3b	Credit for personal exemptions:				1975			
	Form 1040 and 1040A, \$30 × line . . . . .				6d	90.00		90.00
3c	Total tax (including self-employment tax, tax from recomputing prior year investment credit, work incentive credit, and minimum tax, etc.):	1972	1973	1974	1975			
	Form 1040, line . . . . .	22	20	20	20	1,814.37	88.00	1,726.37
	Form 1040A, line . . . . .	21	19	19	15			
(Attach Schedule SE (Form 1040) if self employment tax is changed)								
<b>Payments and Credits</b>								
4	Federal income tax withheld and excess-PICA tax					1,982.00		1,982.00
5	Credits for Federal special fuels, nonhighway gasoline, and lubricating oil tax, also, regulated investment company credit							
6a	Estimated tax payments:	1972	1973	1974	1975			
	Form 1040, line . . . . .	24	21b	21b	21b			
	Form 1040A, line . . . . .	20c	20c	20c	16c			
6b	Earned income credit:				1975			
	Form 1040, line . . . . .				21c			
	Form 1040A, line . . . . .				16d			
7	Amount paid with Form 4868 (application for automatic extension of time to file)							
8	Amount paid with original return, plus additional tax paid after it was filed							
9	Total of lines 4 through 8, column C							1,982.00

PROOF COPY  
(subject to change)

Refund or Balance Due						
10	Overpayment, if any, as shown on original return:	1972	1973	1974	1975	
	Form 1040, line . . . . .	29	24	24	24	167.63
	Form 1040A, line . . . . .	24	23	23	19	
11	Subtract line 10 from line 9, and enter result . . . . .					1,814.37
12	If line 3c, column C is more than line 11, enter BALANCE DUE. Please pay in full with this return . . . . .					
13	If line 3c, column C is less than line 11, enter REFUND to be received . . . . .					88.00

Under penalties of perjury I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which the preparer has any knowledge.

Sign ▶ **John A. Markat** 5/15/76 ▶ Date  
here ▶ **Betty Markat** ▶ Preparer's signature (other than taxpayer's) Date  
Spouse's signature (if filing jointly, BOTH must sign even if only one had income) Address (and ZIP code)

BE SURE TO COMPLETE PAGE 2



Solution to Continuing Problem (Cont. 7)

Form 1040X (Rev. 8-75)

**Part I Exemptions (See Form 1040 Instructions)**  
If exemptions do not change or decrease do not complete lines 4 and 5.

1 Exemptions claimed on this return		Enter number of boxes checked ▶	2.		
a Regular	<input checked="" type="checkbox"/> Yourself <input checked="" type="checkbox"/> Spouse		1		
b Number of your dependent children who lived with you				3	
c Number of other dependents					
d Total (add lines a, b, and c)					
e Age 65 or over	<input type="checkbox"/> Yourself <input type="checkbox"/> Spouse	Enter number of boxes checked ▶			3
Blind	<input type="checkbox"/> Yourself <input type="checkbox"/> Spouse				
f Total exemptions claimed (add lines d and e)					
2 Exemptions claimed on original return.		Enter number of boxes checked ▶	2		
a Regular	<input checked="" type="checkbox"/> Yourself <input checked="" type="checkbox"/> Spouse		1		
b Number of your dependent children who lived with you				3	
c Number of other dependents					
d Total (add lines a, b, and c)					
e Age 65 or over	<input type="checkbox"/> Yourself <input type="checkbox"/> Spouse	Enter number of boxes checked ▶			3
Blind	<input type="checkbox"/> Yourself <input type="checkbox"/> Spouse				
f Total exemptions claimed (add lines d and e)					
3 Difference, if any					
4 Enter first names of your dependent children who lived with you, but were not claimed on original return					
5 Other dependents not claimed on original return:					
(a) NAME ▶ Enter figure 1 in the last column to right for each name listed (if more space is needed, attach schedule)	(b) Relationship	(c) Months lived in your home If born or died during year write "B" or "D"	(d) Did dependent have in come of \$750 or more in 1972, 1973, 1974, or 1975?	(e) Amount YOU furnished for dependent's support if 100% write "ALL"	(f) Amount furnished by OTHERS including dependent
				\$	\$

**Part II Explanation of Changes to Income, Deductions, and Credits**  
Show computations in detail. Attach applicable schedules.

Interest expense not previously deducted - \$400  
On the original return for 1975, no deduction was claimed for the interest paid to the National Bank of Dayton, OHIO, for a personal loan. Interest payments were made quarterly as follows:

11 Jan. 75	\$100.00
9 Apr. 75	100.00
9 July 75	100.00
11 Oct. 75	100.00
	<u>\$400.00</u>

**PROOF COPY**  
 (subject to change)

**Part III Presidential Election Campaign Fund Designation**  
Participation in the Presidential Election Campaign Fund will not increase your tax or reduce your refund.

Check here  if you did not designate \$1 of your taxes but now wish to do so

Check here  if joint return and if spouse did not designate \$1 of taxes but now wishes to do so

# Appendix B: 1975 Form 1040 Road Map

Department  
of the  
Treasury  
Internal  
Revenue  
Service



**volunteer  
income  
tax  
assistance**

**VITA**

# Road Maps

1976  
Edition

For 1975 Form 1040

Publication  
679  
(Rev. 10-75)

# 1040 Roadmap

## 1040

For the year January 1-December 31, 1975, or other taxable year beginning 1975, ending 1975

## US

## 1975

Department of the Treasury—Internal Revenue Service  
**Individual Income Tax Return**

Please place label on form you file. Make all necessary changes on label.	Name (If joint return, give last names and initials of both)	Last name	Your social security number
	Present home address (number and street, including apartment number, or rural route)		For Privacy Act Notification, see page 2 of Instructions.
	City, town or post office, State and ZIP code	Place label here	For IRS use only
		<input type="checkbox"/> Yours <input type="checkbox"/> Spouse's	

**A** In what city, town, village, etc. do you live?

**B** Do you live within the legal limits of the city, town, etc.?

**C** In what county and State do you live?

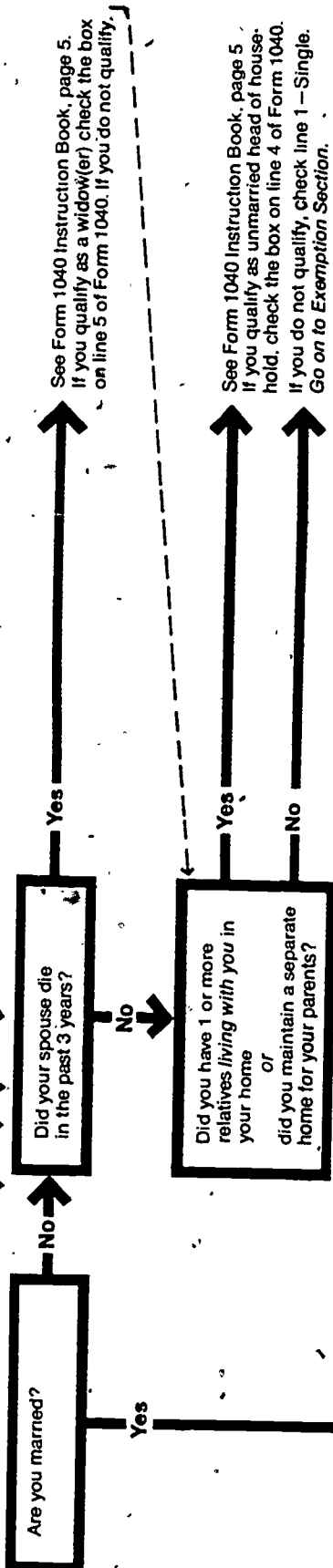
**D** In what township do you live? (See page 4.)

Requested by Census Bureau for Revenue Sharing

## filing status (lines 1-5)

**Filing Status**

- 1  Single (check only ONE box)
- 2  Married filing joint return (even if only one had income)
- 3  Married filing separately. If spouse is also filing, give spouse's social security number in designated space above and enter full name here ▶
- 4  Unmarried Head of Household (See page 5 of Instructions)
- 5  Qualifying widow(er) with dependent child (Year spouse died ▶ 19 ) See page 5 of Instructions



## taxpayer identification

Use the return sent by the Internal Revenue Service.  
 Peel off the blue label affixed to the bottom front cover of the Form 1040 package and place it in the address area of your return  
 Verify each item on the label for accuracy, and make corrections if necessary.  
 Note: If you did not receive a Form 1040 Package, or if the label is not available, follow these directions to complete the taxpayer identification portion of the form.  
 Enter your name (if joint return, enter husband's and wife's first names and middle initials of both) and present home address.

Enter your social security number and occupation. (Enter for both husband and wife if joint return.) Also, fill in the information required by the Census Bureau. See Instruction Book, page 4.  
 Use the diagram to determine your filing status.

\*All references to the Form 1040 Instruction Book are to the Federal Income Tax Forms package which is mailed to all taxpayers who have previously filed an income tax return.

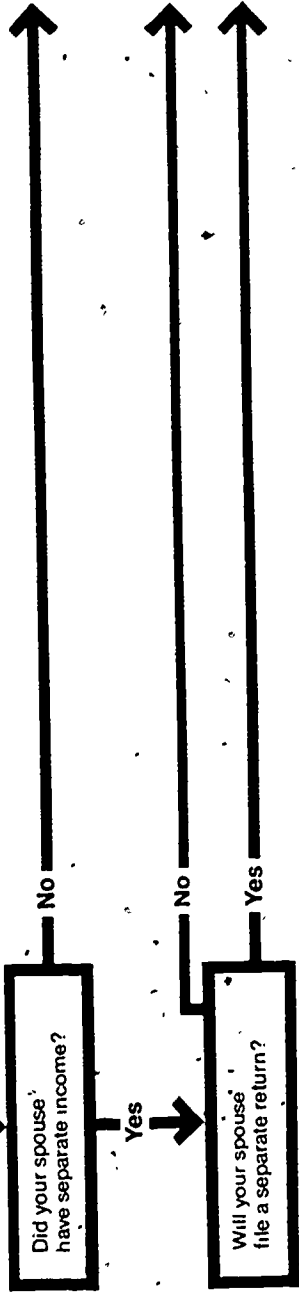
See Form 1040 Instruction Book, page 5. If you qualify as a widow(er) check the box on line 5 of Form 1040. If you do not qualify,

See Form 1040 Instruction Book, page 5. If you qualify as unmarried head of household, check the box on line 4 of Form 1040. If you do not qualify, check line 1 - Single. Go on to Exemption Section.

Check the box on line 2 — married, filing joint return or  
 Check the box on line 2 — married, filing separately. Go on to Exemption Section.

Check the box on line 2 — married, filing joint return. Go on to Exemption Section.

Check the box on line 3 — married, filing separately. If spouse is also filing, write spouse's full name in space provided on line 3, and enter spouse's Social Security number in designated space  
 See instructions on page 5 for certain married taxpayers who may be able to file as "single"  
 Go on to Exemption Section



**exemptions (lines 6-7)**

**Exemptions**

6a Regular  Yourself  Spouse  Enter number of boxes checked

b First names of your dependent children who lived with you \_\_\_\_\_ Enter number

c Number of other dependents (from line 27)

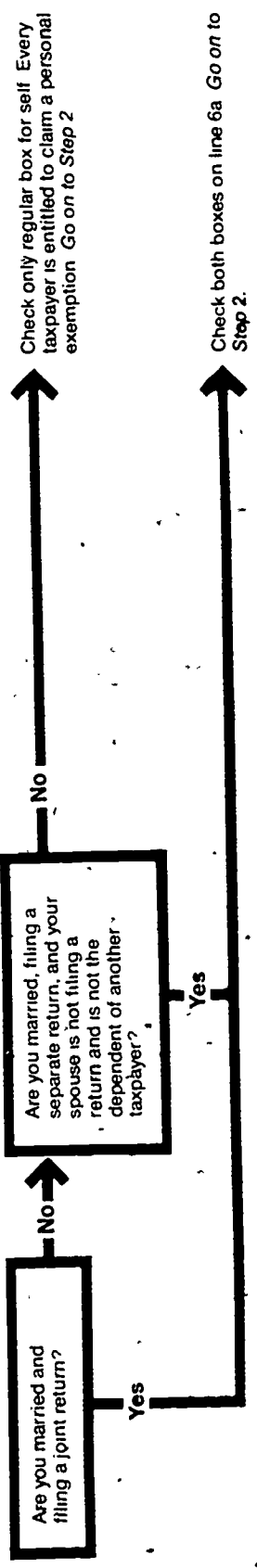
d Total (add lines 6a, b, and c)

e Age 65 or over  Yourself  Spouse  Enter number of boxes checked

Blind  Yourself  Spouse

7 Total (add lines 6d and e)

**Step 1.**

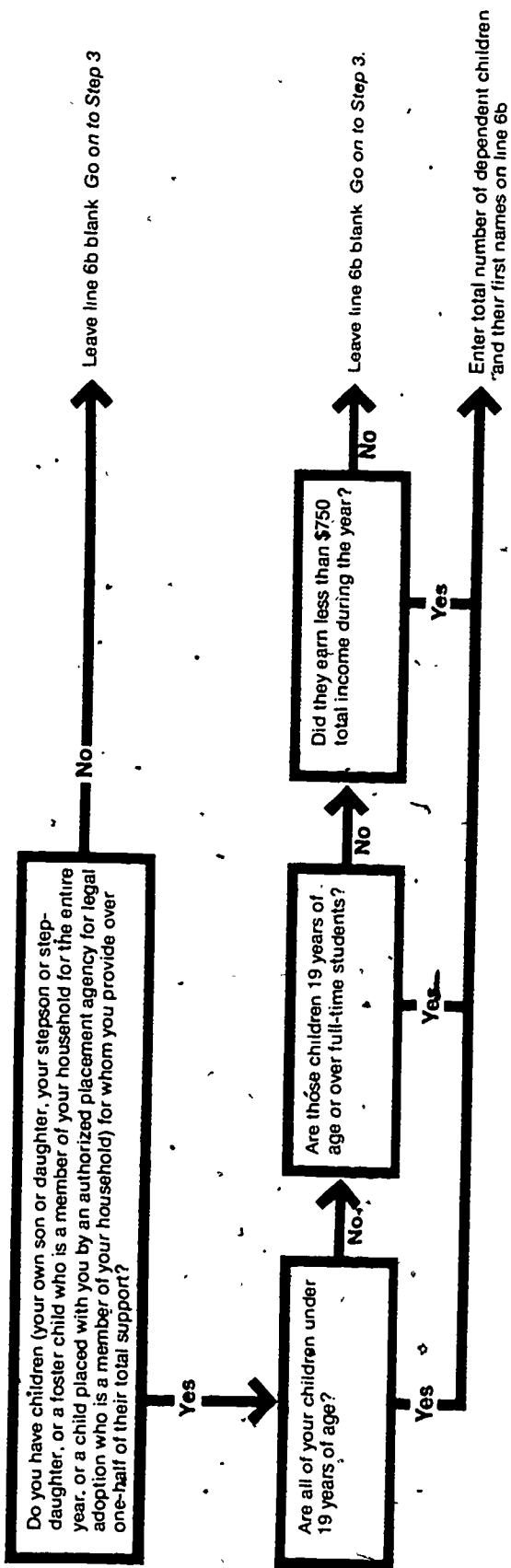


Check only regular box for self. Every taxpayer is entitled to claim a personal exemption. Go on to Step 2

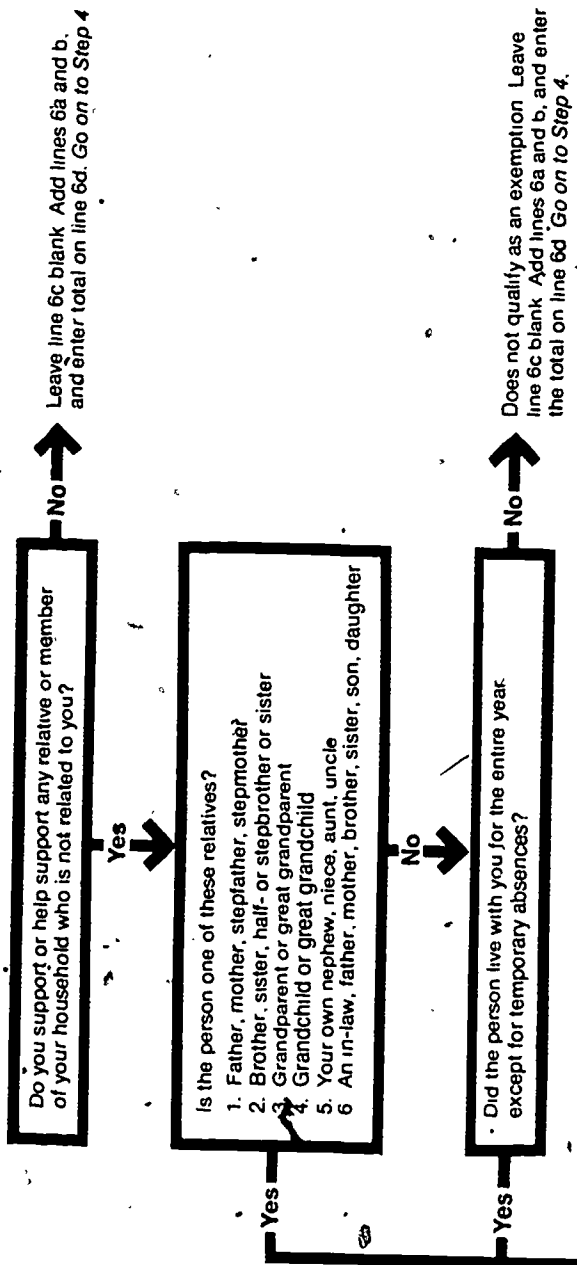
Check both boxes on line 6a. Go on to Step 2.

## exemptions (cont.)

### Step 2.



### Step 3 (Line 6c).





Was the person a citizen or resident of the U. S. or a resident of Mexico, Canada, Panama Canal Zone, Republic of Panama or American Samoa at any time during the year?

Yes

No

Does not qualify as an exemption. See Form 1040 Instruction Book, page 6. Leave line 6c blank. Add lines 6a and b, and enter the total on line 6d. Go on to Step 4.

Did you supply more than half of the person's support?

Yes

No

Stop See Form 1040 Instruction Book, page 6. Go on to Step 4.

Was the person's income \$750 or more?

No

Does not qualify. Leave line 6c blank. Add lines 6a and b, and enter the total on line 6d. Go on to Step 4.

Is the person married?

Yes

Has the person filed a joint return with his spouse?

Yes

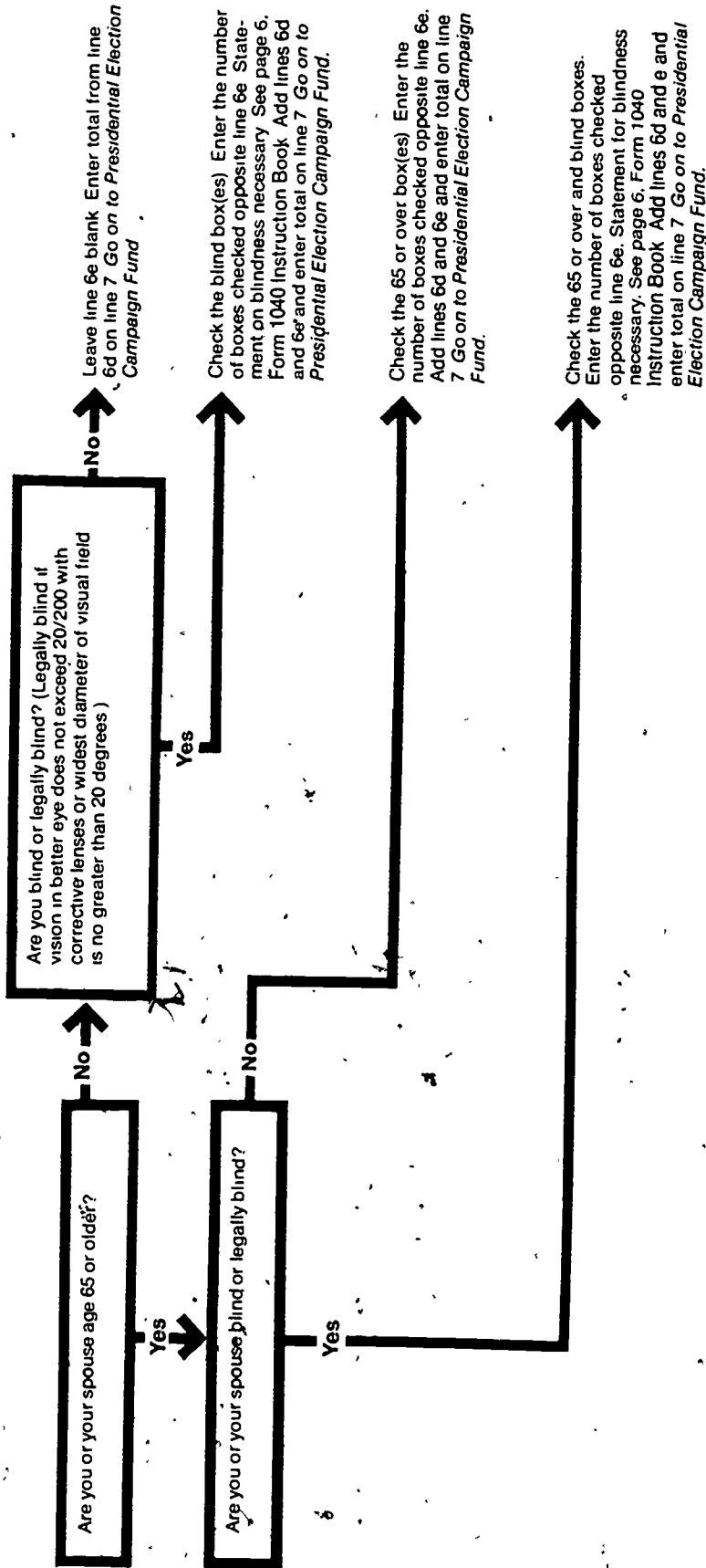
Stop See Form 1040 Instruction Book, page 6. Go on to Step 4.

No

Qualifies as an exemption. Enter the number of other dependents on line 6c (from line 27). Add lines 6a, b and c and enter the total on line 6d. Go on to Step 4.

**Step 4.**

Answer the following questions to determine the number of exemptions you may claim on line 6e (Husband and wife must be considered individually).



**presidential election campaign fund (line 8)**

8 Presidential Election Campaign Fund Do you wish to designate \$1 of your taxes for this fund? If joint return, does your spouse wish to designate \$1?

Yes No  
 Yes  No  
 Yes  No  
 Made if you check the "Yes" box(es) it will not increase your tax or reduce your refund.

If you wish \$1 of your tax liability (\$2 if married filing jointly) to go to the Presidential Election Campaign Fund, check the appropriate box(es) on line 8.



# Income (lines 9-15)

9	Wages, salaries, tips, and other employee compensation (Attach Form W-2 if unearned; also see page 3 of instructions)	9
10a	Dividends (if applicable) \$ 10b Less exclusion \$ Balance (if gross dividends and other distributions are over \$400, list in Part I of Schedule B)	10c
11	Interest income (If \$400 or less, enter total without listing in Schedule B; if over \$400, enter total and list in Part II of Schedule B)	11
12	Income other than wages, dividends, and interest (from line 36)	12
13	Total (add lines 9, 10c, 11, and 12)	13
14	Adjustments to income (such as "sick pay," moving expenses, etc. from line 42) (if less than \$1,000, see page 8 of instructions on Earned Income Credit)	14
15	Subtract line 14 from line 13 (Adjusted Gross Income) (If you do not itemize deductions and line 15 is under \$15,000, find tax in Tables and enter on line 16a. If you itemize deductions or line 15 is \$15,000 or more, go to line 43 to figure tax)	15

CAUTION: If you have unearned income and can be claimed as a dependent on your parent's return, check here and see page 7 of instructions

## Step 1.

Did you have income from wages, salaries, tips, bonuses, commissions, fees and gratuities?

No

Yes

## Step 2.

Did you have dividend income?

Yes

No

**You May Have IRS Compute Your Tax.**  
If your income on line 15 is \$20,000 or less and consists only of wages, salary and tips, dividends, interest, pensions and annuities, and you choose the standard deduction instead of itemizing, you may have the Service figure your tax for you.

- The Service will compute your tax if you
- Fill in lines 1 through 15, lines 17, 19, 21a, 21b, 21c and 21e, if applicable, and line 27.
  - Skip lines 16a, b, and c, 18, 20 and 22 through 26.
  - If you are filing a joint return, show husband's and wife's income separately in the space to the left of the entry space for line 15.
  - File your return on or before April 15, 1976.
- The Service will then compute your tax and refund any overpayment or bill you for any amount you owe.

**Note:** If you elect to have IRS compute your tax, the Service will also figure your retirement income credit if you answer the question on Schedule R for columns A and B and fill in only lines 2 and 5 of Schedule R and enter RIC on line 17 of Form 1040.

Enter your total income from all Forms W-2 (or statements) on line 9, if you had no other income enter on line 13 the amount you put on line 9. Go on to Step 5.

If you had other income, go on to Step 2. If you did not receive a Form W-2 from each employer, contact your employer for missing W-2s. If you cannot get them, attach a statement reporting all your income and explaining how you computed, any tax withheld for which you claim credit.

Go on to Step 2

Go on to Step 3.

See Form 1040 Instruction Book, page 6, for reporting dividend income. Enter the total on line 10c if you had more than \$400 income from dividends, you must also fill out Schedule B if you had other income, go on to Step 3.

If you had no other income, enter the total of lines 9 and 10c on line 13. Go on to Step 5.

**Step 3.**

Did you have income from interest?

Yes →

No →

Go on to Step 4.

Was the interest on any of the following?  
 1. State, county, city or school bonds  
 2. Bonds financed (sold) by the District of Columbia or a U. S. possessing  
 3. Debts owed by a port authority, toll road commission, or utility authority

Yes →

No →

You do not have to pay taxes on this income. If this is your only income from interest, leave line 11 blank, and go on to Step 4. If you had additional interest income.

Go on to Step 4.

Did you have interest on any of the following?  
 1. Bank account, loan, or note  
 2. Tax refund  
 3. Building and loan or savings and loan account  
 4. Credit union account  
 5 U S. Savings Bonds

Yes →

This is reportable income. Enter your total interest income on line 11 of Form 1040. If you had more than \$400 income from interest, you must also fill out Schedule B. Go on to Step 4.

**Step 4.**

Did you have income or loss from any of these?  
 1. Business, profession, or farm  
 2. Sale or exchange of property  
 3. Pension, annuity, or endowment  
 4. Rents or royalties

Yes →

Stop

Determine your income or loss figure and enter it on the proper supporting Schedules (B, C, D, E, or F) provided in Form 1040 Instruction Book, and Part 1 on page 2 of Form 1040. Enter your total income from these sources on line 12.

No →

Did you have income from any of the following?  
 1. Social security benefits  
 2. Veterans disability benefits  
 3. Workmen's compensation  
 4. Gifts, bequests, or an inheritance  
 5. Dividends on veterans insurance  
 6. Railroad retirement benefits  
 7. Death proceeds from life insurance  
 8. Insurance compensation for excess living expenses due to a casualty

Yes →

You do not have to pay taxes on this income, and it does not have to be reported.

No →

Add lines 9, 10c, 11, and 12. Enter the total on line 13. Go to Step 5.

**Step 5.**

Did you receive sick pay, or have moving expenses, employee business expenses, or make payments to a self-employment retirement plan or forfeited interest penalty for premature withdrawal?

Yes →

Stop

See Form 1040 Instruction Book, page 9. Enter the total amount of your adjustments in Part II on page 2 of Form 1040 and on line 14. Then subtract line 14 from line 13, and enter the difference on line 15.

No →

Enter the total from line 13 on line 15. Leave line 14 blank.

# tax, payments and credits (lines 16-22)

Tax Rate Schedule X, Y, or Z  
 Schedule D  Schedule G  Form 4726

16a Tax, check if from  
 Schedule D  Schedule G  Form 4726

b Credit for personal exemptions (multiply line 6d by \$30)

c Balance (subtract line 16b from line 16a)

17 Credits (from line 54)

18 Balance (subtract line 17 from line 16c)

19 Other taxes (from line 63)

20 Total (add lines 18 and 19)

21a Total Federal income tax withheld (attach Forms W-2 or W-2e from front) (include amount allowed as credit from 1974 return)

b 1975 estimated tax payments

c Earned income credit

d Amount paid with Form 4868

e Other payments (from line 67)

22 Total (add lines 21a through e)

16a 16b 16c 17 18 19 20

21a 21b 21c 21d 21e

22

Pay amount on line 23 in full with this return. Write social security number on check or money order and make payable to Internal Revenue Service

**Stop**

**Stop**

## Step 1.

Is the amount you entered on line 15 \$15,000 or more?

No

During the tax year, did you spend 16% or more of the amount you entered on line 15 for the following?

1. Medical or dental bills
2. Contributions
3. Taxes
4. Interest
5. Casualty or theft loss
6. Child care and dependent care expenses
7. Other miscellaneous deductions

No

Did you check the box on line 1 (the "single" box), or did you check the box on either line 2, 4, or 5?

No

Did you check the box on line 3?

Use Part III, on page 2 of Form 1040, to figure your tax. Enter the tax on line 16a. On line 16b enter credit for personal exemption (multiply line 6d by \$30) and subtract line 16a from line 16b. Go to Step 2.

It is probably to your advantage to itemize your deductions. You should consider itemizing deductions if you had a major, uninsured casualty loss; paid large amounts of state, county, or other local taxes, own your own home on which you are paying interest and taxes, or made alimony payments. Use Schedule A, Form 1040 Instruction Book, and Part III on page 2 of Form 1040 to figure your tax. Enter the amount on 16a. On line 16b enter credit for personal exemption (multiply line 6d by \$30) and subtract line 16a from line 16b. Go on to Step 2.

Use tax tables (depending on total exemptions claimed on line 7) in your 1040 Instruction Book to find your tax. Check box for "Tax Tables" and enter the amount on line 16a. On line 16b enter credit for personal exemption (multiply line 6d by \$30) and subtract line 16a from line 16b. Go on to Step 2.

Use tax tables (depending on total exemptions claimed on line 7) in your 1040 Instruction Book to find your tax. If spouse is also filing, both must use same method of claiming deductions. Check box for "Tax Tables" and enter the amount on line 16a. On line 16b enter credit for personal exemption (multiply line 6d by \$30) and subtract line 16a from line 16b. Go on to Step 2.



**Step 2.**

Did you have retirement income credit, investment credit, foreign tax credit (line 17), gasoline credit or regulated investment company credit (line 17) or did you make estimated tax payments in 1975 (line 21b)?

Yes

**Stop**

You should not attempt to complete your return using this Road Map. See an IRS Taxpayer Service Representative for assistance.

No

In addition, if you are eligible for the earned income credit (see Instructions, page 8) you should also see an Internal Revenue Service Taxpayer Service Representative for assistance.

Leave lines 17, 19, 21b and 21d blank.  
On lines 18 and 20, enter the amount from line 16.  
On lines 21a and 22, enter the total Federal income tax withheld (from forms W-2). Go on to *Balance Due or Refund*.

**balance due or refund (lines 23-26)**

23	If line 20 is larger than line 22, enter <b>BALANCE DUE IRS</b> . (Check here <input type="checkbox"/> if Form 2210, Form 2210F, or statement is attached. See page 8 of instructions.)	23	_____
24	If line 22 is larger than line 20, enter amount <b>OVERPAID</b>	24	_____
25	Amount of line 24 to be <b>REFUNDED TO YOU</b>	25	_____
26	Amount of line 24 to be credited on 1976 estimated tax.	26	_____

If all of overpayment (line 24) is to be refunded (line 25), check box

Is the amount on line 20 larger than the amount on line 22?

Yes

Subtract line 22 from line 20, and write the difference on line 23. This is the amount of the tax you owe. Enclose check or money order for this amount when you mail in your Form 1040.

No

Is the amount on line 22 larger than the amount on line 20?

Yes

Subtract line 20 from line 22, and write the difference on line 24. This is the amount of the tax-credit or refund you will receive.  
a. If you wish to have the amount on line 24 credited to your 1976 estimated tax, write that amount on line 26  
b. If you wish to have the amount on line 24 refunded to you, write that amount on line 25.

No

Enter zeros on lines 25 and 26. You have already paid all of the taxes you owe for 1975. Go on to last section.

# completing your return

**Sign here**

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

<p>▲ Your signature _____ Date _____</p> <p>Spouse's signature (if filing jointly; BOTH must sign even if only one had income) _____</p>	<p>▲ Preparer's signature (other than taxpayer) _____</p> <p>Address (and ZIP Code) _____</p>
--	---

**Make sure you sign and date your return. Both husband and wife must sign a joint return.**

You have now completed your 1975 income tax return. Please take a few minutes to check your return to make sure your figures are correct, that all necessary lines are completed, and that all necessary forms and schedules are attached.

After checking and signing your return, and enclosing a check or money order if you owe tax, mail your return in the pre-addressed envelope provided in the Form 1040 Instruction Book. If the pre-addressed envelope is not available, a complete list of Internal Revenue Service Centers is available on page 4 of the Form 1040 Instruction Book.

# Appendix C: Dependency Exemption Charts

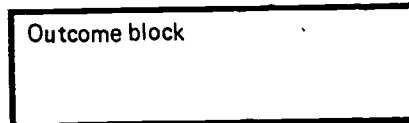
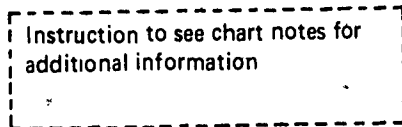
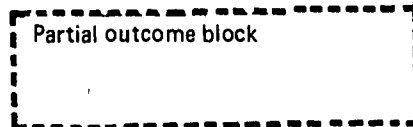
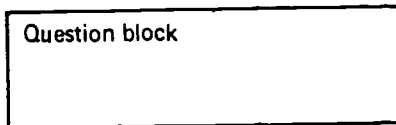
## How To Use Charts

Dependency Exemption Charts 1, 2, and 3 are something like road maps. They are really flow charts to help you quickly find an answer to the taxpayer's question.

We use several symbols on the charts. The symbols and their meanings are given below. (Note differing darkness of blocks.)



Beginning point or first question on chart



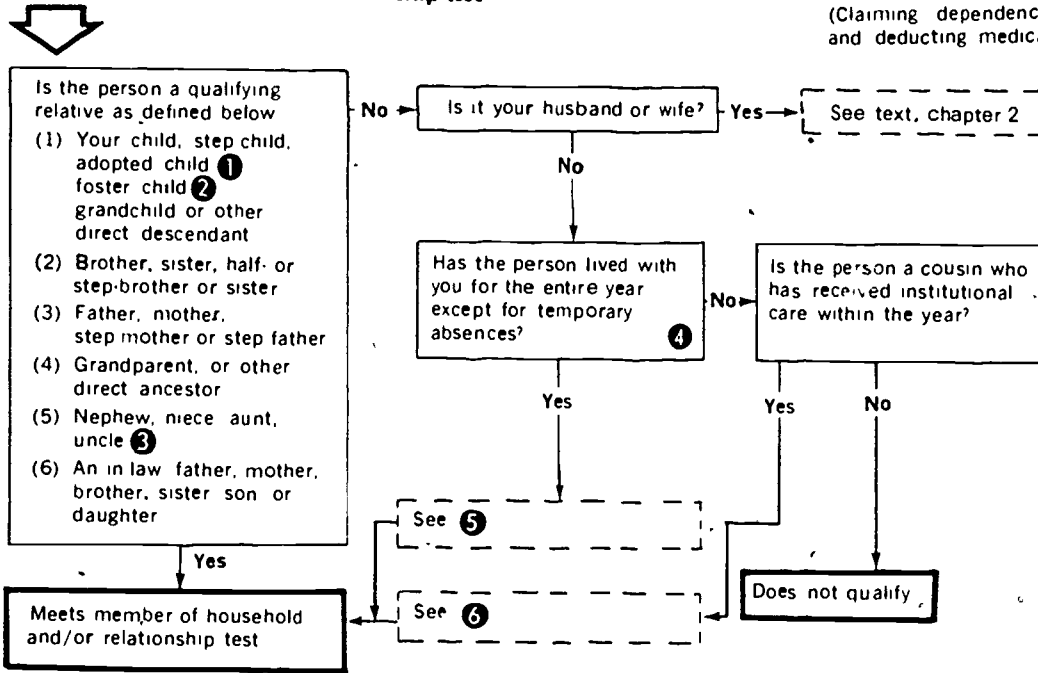
There are notes for each chart. The notes contain additional technical information and references.

# Test for Dependents

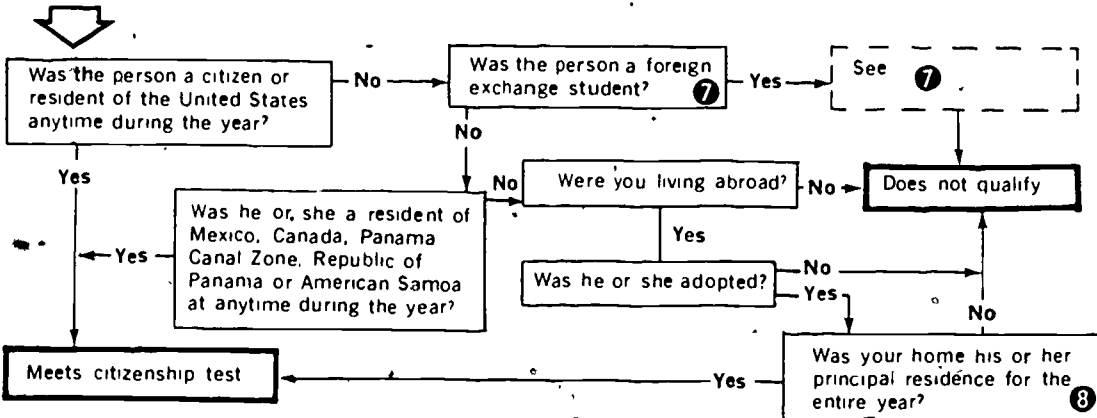
## Member of household and/or relationship test

See chapter 2

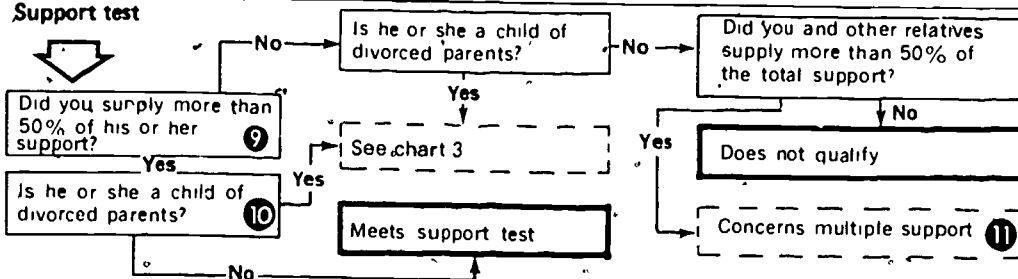
(Claiming dependency exemption and deducting medical expenses)



## Citizenship test



## Support test



## Test for Dependents

**1**

Adopted child—A child who has been (a) legally adopted by you, or (b) has been placed in your home for adoption by a placement agency recognized by your State and been a member of your household since the placement. A child placed for adoption does not have to be a member of your household for the entire year to meet the member of household relationship test

See Publication 17, ch 4

**2**

If a foster child has lived with you for the entire year except for temporary absences, he or she shall be treated as your natural child.

**3**

If you are married and filing a separate return, you cannot claim your spouse's nephew, niece, aunt or uncle unless they are members of your household

See Publication 17, ch 4

**4**

Absences such as those for vacation, school or sickness are temporary. An unknown length of stay in a nursing home for constant medical care is also considered a temporary absence

**5**

Provided the relationship is not in violation of local law the person qualifies as a member of your household

See Publication 17, ch 4

**6**

To meet this test, your cousin must have been a member of your household before receiving institutional care

**7**

Foreign exchange students generally may not be claimed as dependents. For possible deduction under Contributions, see Publication 17, ch 23

**8**

Principal residence means the same thing as "lived with you for the entire year except for temporary absences". We use both terms because you will encounter both of them in your work

**9**

Items considered support: food, shelter, clothing, lodging (at fair market value), education, medical and dental care, recreation, transportation, and similar necessities

Items not considered support: Income tax (Federal, State and local), social security tax, life insurance premiums, funeral expenses, automobiles, boats, and other capital expenditures

See Publication 17, ch 4

**10**

Divorced or legally separated under a decree of divorce or of separate maintenance or are separated under a written separation agreement

See Publication 17, ch 2

**11**

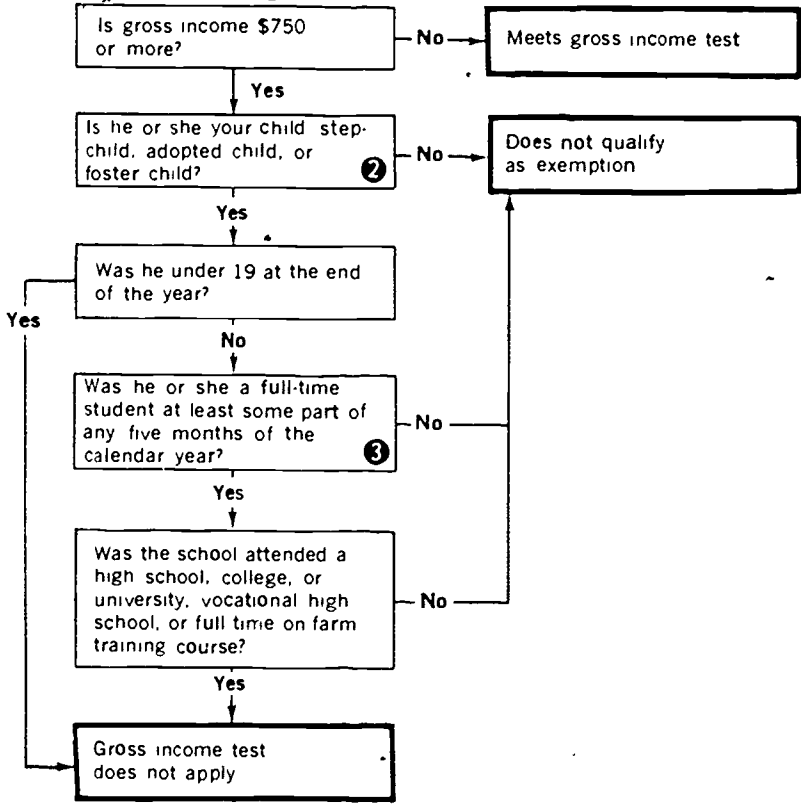
In some cases no one person provides more than half the support of a dependent. If, in these instances, two or more persons contribute more than half a dependent's support, a multiple support agreement may be reached

See Publication 17, ch 4

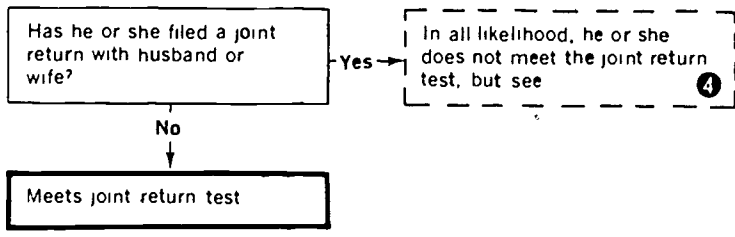


# Dependency Exemptions <sup>1</sup>

**Gross income test** (Use chart 1, Tests for Dependents, plus this chart)



**Joint return test** (If the person you wish to claim is married, complete this test)



## Dependency Exemptions

①

To claim a \$750 exemption for a dependent, the dependent must meet the two tests on this chart, plus the three tests on Chart 1. However, for dependency purposes, if a taxpayer's child is less than 19 years of age or is a full-time student, regardless of age, the gross income test does not apply. (This chart applies to calendar year taxpayers only.)

②

This includes a child who is a member of your household placed with you by an authorized placement agency for legal adoption.

③

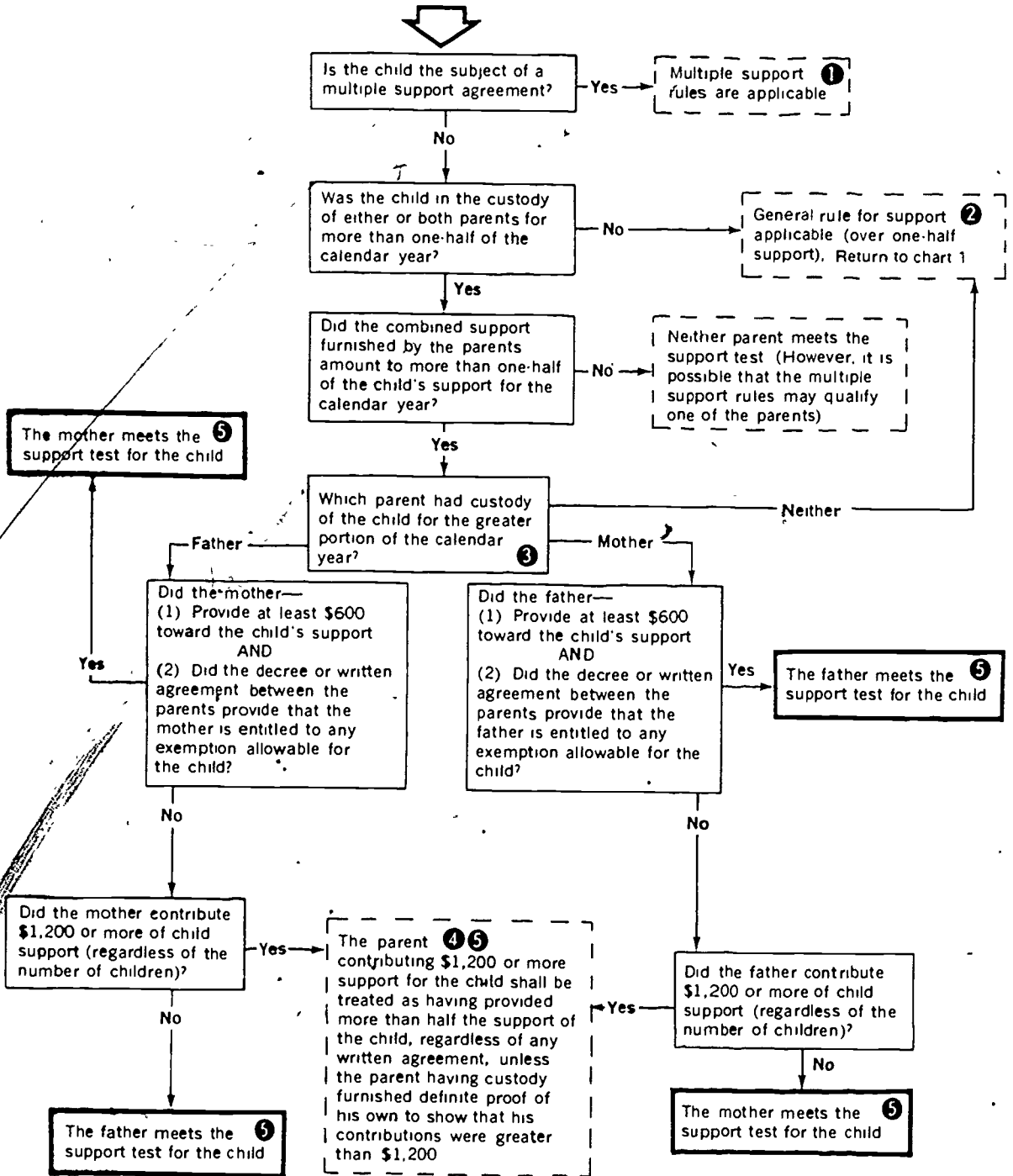
A full-time student is one who is enrolled for the number of hours or courses considered full-time attendance by the school attended. See Publication 17, ch. 4.

④

Exception to the joint return test.

An exemption may be claimed for a married dependent if neither the dependent nor the spouse is required to file a return but they file a joint return to claim a refund of tax withheld.

# Support Test for Child of Divorced Parents



## Support Test for Child of Divorced Parents

**1**

Narrative description of rules. See Publication 17, ch. 4.

**2**

Return to Chart 1 and compute support from the items listed in note 9.

**3**

If the divorced parent having custody remarries, support provided by the new spouse will be treated as furnished by the divorced parent having custody.

**4**

Each parent is entitled to an itemized statement of the expenditures upon which the other parent's claim of support furnished is based.

If a parent intends to claim a child as a dependent and has either made a request of or received a request from the other parent regarding the child's expenses or exemption and does not know the other parent's intention by filing time, the parent must attach an itemized statement to the return, and if available, the other parent's statement.

The itemized statement should include the following information (which applies to either a child or children):

1) the name of the child (or children) being claimed, names of both parents, and, if known, the addresses and social security numbers of each parent;

2) the number of months each parent had custody of the child, the amount of income of the child, and the total amount of support for the child, including amounts provided by other than the parent;

3) an itemized listing of the amounts spent during the year by the parent making the statement, for medical and dental care, food, shelter, recreation and transportation, clothing and education;

4) amounts actually paid by the parent making the statement, pursuant to a divorce decree or written separation agreement; and

5) other amounts paid during the year for support of the child, by the person making the statement.

**5**

If member of household and citizenship tests have already been met, go back to Chart 2. If not, go to Chart 1.

# Appendix D: Major Applicable Tax Forms

Form **1040NR** | **U.S. Nonresident Alien Income Tax Return** | **1975**  
 Department of the Treasury | For the year January 1-December 31, 1975, or other taxable year beginning |  
 Internal Revenue Service | 1975, and ending | 19

**Please print or type**

First name and initial: \_\_\_\_\_ Last name: \_\_\_\_\_

Present home address (Number and street, including apartment number or rural route): \_\_\_\_\_ Identifying number: \_\_\_\_\_

City, town, or post office, State and ZIP code: \_\_\_\_\_ Check whether  Individual  Fiduciary Occupation in the U.S.: \_\_\_\_\_

Of what country were you a citizen or national during the taxable year? ▶ \_\_\_\_\_

Give address to which you want any refund check mailed: \_\_\_\_\_ Give address in the country where you are a permanent resident: \_\_\_\_\_

Note: Was 100% of your income received from U.S. sources not "effectively connected" with U.S. trade or business?  Yes  No  
 If "Yes," answer the questions on page 3 complete appropriate items on page 4 then complete appropriate items on lines 21 through 28 on page 4

**Filing Status and Exemptions for Individuals**

Filing Status (check only one box)	Regular		Enter Total
	Yourself	Spouse	
1 <input type="checkbox"/> Single resident of American Samoa, Canada, or Mexico			
2 <input type="checkbox"/> Other single, nonresident alien			
3 <input type="checkbox"/> Married resident of American Samoa, Canada, or Mexico			
4 <input type="checkbox"/> Married resident of Japan (spouse must live in the U.S.)			
5 <input type="checkbox"/> Other married nonresident alien			
6 <input type="checkbox"/> Qualifying widow(er) with dependent child (Year spouse died ▶ 19____). (See Instruction N)			

7 Exemptions for your children and other dependents from page 2, line 31: \_\_\_\_\_

8 Total (add lines 1 through 7): \_\_\_\_\_

9 Age 65 or over  Yourself  Spouse | Applicable to residents of American Samoa, Canada, or Mexico only | Enter number of boxes checked: \_\_\_\_\_  
 Blind  Yourself  Spouse

10 Total exemptions claimed (add lines 8 and 9): \_\_\_\_\_

**Income Effectively Connected with U.S. Trade or Business**

11 Wages, salaries, tips, and other employee compensation	11
12a Dividends (see instructions)	12c
12b Less: exclusion	
13 Interest income	13
14 Income other than wages, dividends, and interest (from line 41)	14
15 Total (add lines 11, 12c, 13, and 14)	15
16 Adjustments to income (such as "sick pay," moving expenses, etc. from line 47)	16
17 Adjusted Gross Income (subtract line 16 from line 15) Enter balance on line 48	17

**Tax, Payments, and Credits**

18a Tax on income effectively connected with U.S. trade or business (Check if from: <input type="checkbox"/> Tax Rate Schedule, <input type="checkbox"/> Schedule D, OR <input type="checkbox"/> Form 4726)	18a
b Credit for personal exemptions (multiply line 8 by \$30)	b
c Balance (subtract line 18b from line 18a)	c
19 Total credits (from line 58)	19
20 Income tax after credits (subtract line 19 from line 18c)	20
21 Total other taxes from line 64 (includes tax on income not effectively connected with U.S. trade or business)	21
22 Total tax (add lines 20 and 21)	22
23a Total Federal income tax withheld (attach Forms W-2 or W-2P)	23a
b 1975 estimated tax payments (include amount allowed as credit from 1974 return)	b
c Earned income credit (See Instruction R)	c
d Amount paid with Form 4868	d
e Other payments (from line 68)	e
24 Total (add lines 23a through e)	24

**Balance Due or Refund**

25 If line 22 is larger than line 24, enter BALANCE DUE IRS	25
26 If line 24 is larger than line 22, enter amount OVERPAID	26
27 Amount of line 26 to be REFUNDED TO YOU	27
28 Amount of line 26 to be credited on 1976 estimated tax. ▶ 28	

If all of overpayment (line 26) is to be refunded (line 27), make no entry on line 28

**Sign here**

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge

Preparer's signature (other than taxpayer) \_\_\_\_\_ Date \_\_\_\_\_

Your signature \_\_\_\_\_ Address (and ZIP code) \_\_\_\_\_



- 29 List first names of dependent children of residents of American Samoa, Canada, Mexico, and Japan Japanese children must live with parent in U.S. Enter number ▶
- 30 Other dependents (applies to residents of American Samoa, Canada, and Mexico) Give full name, relationship, and months lived with you Enter number ▶
- 31 Total exemptions for your children and other dependents (add lines 29 and 30) Enter here and on line 7 ▶

**PART I.—Income Other Than Wages, Dividends, and Interest Effectively Connected with U.S. Trade or Business**

32 Business income or (loss) (attach Schedule C (Form 1040))	32		
33a Net gain or (loss) from sale or exchange of capital assets (attach Schedule D (Form 1040))	33a		
b 50% of capital gain distributions (not reported on Schedule D (Form 1040))	b		
34 Net gain or (loss) from Supplemental Schedule of Gains and Losses (attach Form 4797)	34		
35 Rents and royalties, partnerships, estates, or trusts, etc. (attach Schedule E (Form 1040))	35		
36 Farm income or (loss) (attach Schedule F (Form 1040))	36		
37 Scholarships and fellowships (attach explanation)	37		
38 State income tax refunds (see instructions)	38		
39 Awards and prizes	39		
40 Other (state nature and source) ▶	40		
41 Total (add lines 32 through 40) Enter here and on line 14	41		

**PART II.—Adjustments to Income**

42 "Sick pay" (attach Form 2440 or other required statement)	42		
43 Moving expense (attach Form 3903)	43		
44 Employee business expense (attach Form 2106 or other statement)	44		
45 Scholarships and fellowships excluded (attach explanation)	45		
46 Forfeited interest penalty for premature withdrawal (see instructions)	46		
47 Total (add lines 42 through 46) Enter here and on line 16	47		

**PART III.—Tax Computation for Income Effectively Connected with U.S. Trade or Business**

48 Adjusted gross income (from line 17)	48		
49 Total deductions (from line 21)	49		
50 Subtract line 49 from line 48	50		
51 Exemption:	51		
a Individuals—multiply \$750 by the number of exemptions on line 10			
b Estates and trusts—(see instructions)			
52 Taxable income (subtract line 51 from line 50)	52		

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(Compute the tax on the amount on line 52 using the appropriate tax rate schedule in the Instructions for Form 1040NR, or if applicable, the alternative tax on Schedule D (Form 1040), or the maximum tax on Form 4726) Enter the tax on line 18a.

**PART IV.—Credits**

53 Investment credit (attach Form 3468)	53		
54 Foreign tax credit (attach Form 1116)	54		
55 Contributions to candidates for public office credit (see instructions)	55		
56 Work incentive (WIN) credit (attach Form 4874)	56		
57 Purchase of new principal residence credit (attach Form 5405)	57		
58 Total (add lines 53 through 57) Enter here and on line 19	58		

**PART V.—Other Taxes**

59 Tax from recomputing prior-year investment credit (attach Form 4255)	59		
60 Tax from recomputing prior-year work incentive (WIN) credit (attach schedule)	60		
61 Minimum tax. Check here <input type="checkbox"/> if Form 4625 is attached	61		
62 Tax on income "not effectively connected" with U.S. trade or business (from page 4, line 13)	62		
63a Social security tax on tip income not reported to employer (attach Form 4137)	63a		
b Uncollected employee social security tax on tips (from Forms W-2)	b		
c Total (add lines 63a and b)	63c		
64 Total (add lines 59 through 63c) Enter here and on line 21	64		

**PART VI.—Other Payments**

65 Excess FICA, RRTA, or FICA/RRTA tax withheld (two or more employers—see instructions)	65		
66 Credit for Federal tax on special fuels, nonhighway gasoline and lubricating oil (attach Form 4136)	66		
67 Other credits and payments:			
a Regulated investment company credit	67a		
b Credit for amount paid with Form 1040C	b		
c U.S. tax withheld at source (from page 4, line 10)	c		
d Total (add lines 67a through c)	67d		
68 Total (add lines 65 through 67d) Enter here and on line 24e	68		



**PART VII.—Deductions**

Enter in this schedule deductions such as charitable contributions, and casualty and theft losses. Also enter those deductions, such as state and local income taxes, which are connected with income effectively connected with the conduct of a trade or business within the U.S.

69a State income taxes			73a Personal casualty or theft loss after insurance reimbursement		
b Local income taxes			Note: If you had more than one loss, omit lines 73a and b and see page 2 of Instructions.		
70 Total state and local income taxes Enter here and on line 77 . . . . .			b Subtract \$100 or amount on line 73a, whichever is smaller . . . . .		
71 Contributions (Itemize)			74 Casualty or theft loss. Enter here and on line 79 . . . . .		
. . . . .			75 Other deductions (Itemize)		
. . . . .			76 Total other deductions. Enter here and on line 80 . . . . .		
. . . . .			77 Taxes (from line 70) . . . . .		
. . . . .			78 Contributions (from line 72) . . . . .		
. . . . .			79 Casualty or theft loss (from line 74) . . . . .		
. . . . .			80 Other deductions (from line 76) . . . . .		
. . . . .			81 Total deductions. Enter here and on page 2, line 49		
72 Total contributions. Enter here and on line 78					

Please Answer All Questions

- A What country issued your passport? . . . . .
- B Were you ever a U.S. citizen? . . . . .  Yes  No
- C Give the purpose of your visit to the U.S. . . . .
- D Type of entry visa and visa number . . . . .
- E Did you abandon your permanent residence as an immigrant in the U.S. this year? . . . . .  Yes  No
- F Dates you entered and left the U.S. during the year. (Residents of Canada or Mexico entering and leaving the U.S. at frequent intervals, give name of country only) . . . . .
- G Nonresident aliens from tax treaty countries Give number of days during the taxable year (including vacation and non work days) you were physically present in the U.S.
- H Residents of American Samoa, Canada, Mexico, or Japan. Did your spouse contribute to the support of any children claimed on Form 1040NR, line 29? . . . . .  Yes  No  
If "Yes," state amount \$ . . . . .
- I Did you file a U.S. income tax return for any year before 1975? . . . . .  Yes  No  
If "Yes," give the latest year and form number . . . . .  
To which Internal Revenue office was it sent? . . . . .
- J To which Internal Revenue office did you pay any amounts claimed, on Form 1040NR, lines 23b, 23d, and 67b . . . . .

- K How much you excluded from gross income in this return any amount, other than foreign source income not effectively connected with a U.S. trade or business? . . . . .  Yes  No  
If "Yes," attach statement showing amount, nature, and source of each such item of income and the reason it was excluded from gross income.
- L If you claim the benefits of a U.S. income tax convention with a foreign country, furnish the following information:  
Country . . . . .  
Type and amount of income claimed to be exempt under the applicable tax treaty:  
in current year . . . . .  
in prior years . . . . .
- M Were you subject to tax in that country on any of the income you claim is entitled to the convention benefits? . . . . .  Yes  No  
Did you have a permanent establishment (as defined by the tax convention and section 894(b) of the Code) in the U.S. at any time during the year? . . . . .  Yes  No
- N If you are filing this return for a nonresident alien spouse to report community income, give spouse's name, address, and social security number and Internal Revenue office where filed . . . . .
- O Did you file Form 1040C or Form 2063 during the taxable year? . . . . .  Yes  No  
If "Yes" state Internal Revenue office where you filed . . . . .

Date filed ▶

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**Computation of Tax on Income Not Effectively Connected with U.S. Trade or Business**  
 (Provide the name and address of withholding agent(s) and/or payer(s) of income on an attachment to this return.)

Nature of Income	Enter amount of income under the appropriate rate of tax						(g) 30%
	(a) 2%	(b) 5%	(c) 10%	(d) 14%	(e) 15%	(f) 27 1/2%	
<b>1 Dividends paid by:</b>							
<b>a U.S. corporations</b>							
<b>b Foreign corporations</b>							
<b>2 Interest</b>							
<b>a Mortgage</b>							
<b>b Paid by foreign corporations</b>							
<b>c Others</b>							
<b>3 Copyrights</b>							
<b>4 Industrial royalties</b>							
<b>5 Natural resources</b>							
<b>6 Real property income</b>							
<b>7 Pensions and annuities</b>							
<b>8 Capital gains (enter gains from line 14 below)</b>							
<b>9 Other (specify) _____</b>							
<b>10 Total tax withheld at source. Enter here and on Form 1040NR, line 67c.</b>							
<b>11 Total income (add lines 1 through 9 for each column)</b>							
<b>12 Tax on income (multiply income on line 11 by rate of tax)</b>							
<b>13 Total tax on income not effectively connected (combine all totals on line 12). Enter here and on Form 1040NR, line 62</b>							

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**Gains and Losses from Sales or Exchanges of Property**

Kind of property (if necessary, attach statement of descriptive details not shown below)	Date of acquisition (b)	Date of sale (c)	Gross sales price (d)	Depreciation allowed (or allowable) since acquisition (e)	Cost of other basis, cost of subsequent improvements (if not purchased at acquisition), and expense of sale (f)	Gain or loss (column (d) plus column (e) less column (f)) (g)

**14 Net gain. Enter on line 8 above**



# Application for Extension of Time for Filing U.S. Income Tax Return

(For U.S. Citizens Abroad Who Expect to Qualify For Exempt Earned Income)

File in duplicate on or before the due date for filing your return. See instructions on reverse

Please Print or Type	Name of taxpayer	Your social security number
	Number and street, or rural route	Spouse's social security number
	City or town, State, and ZIP code or country	

- I request an extension of time until \_\_\_\_\_ to file my income tax return for the year ended \_\_\_\_\_ because I expect to qualify for exemption on my income earned in foreign countries during that year for the reason stated below (Check one)
  - Bona fide residence in a foreign country or countries for uninterrupted period which includes an entire taxable year
  - Physical presence in a foreign country or countries for 510 full days of any 18 consecutive month period.
- Has an extension of time to file been previously granted for this taxable year?  Yes  No
- Date of first arrival in foreign country \_\_\_\_\_
  - Date qualifying period begins \_\_\_\_\_ ends \_\_\_\_\_
  - Your address of residence in this foreign country \_\_\_\_\_
  - Date of expected return to United States \_\_\_\_\_
- Last permanent address in United States \_\_\_\_\_
- Office where you filed your last return (city and State) \_\_\_\_\_
- Occupation (if self-employed, describe, fully) \_\_\_\_\_
- Name and United States address of employer \_\_\_\_\_
  - Foreign address of employer \_\_\_\_\_

**CAUTIONARY NOTE:**

- Election to have the Internal Revenue Service compute the income tax is not available to the taxpayer with, or without, an extension, if the return is filed after the regular due date.
- Interest accrues on any tax due from the regular due date of the return until paid. For the rate of interest and amount of penalty due to late payment of tax, see Requirements for Filing in the instructions.

**If Prepared by Taxpayer**

Under penalties of perjury, I declare that to the best of my knowledge and belief, the statements made herein are true and correct

Signature of taxpayer \_\_\_\_\_ Date \_\_\_\_\_

Spouse's signature \_\_\_\_\_ Date \_\_\_\_\_

**If Prepared by Someone Other Than Taxpayer**

Under penalties of perjury, I declare that to the best of my knowledge and belief, the statements made herein are true, correct, and complete, that I am authorized by the taxpayer to prepare this application, and that I am:

- A member in good standing of the bar of the highest court of (specify jurisdiction) \_\_\_\_\_
- A certified public accountant duly qualified to practice in (specify jurisdiction) \_\_\_\_\_
- A person enrolled to practice before the Internal Revenue Service.
- A duly authorized agent holding a power of attorney (The power of attorney need not be submitted unless requested)
- A person standing in close personal or business relationship to the taxpayer who is unable to sign this application because of illness, absence, or other good cause. My relationship to the taxpayer and the reasons why the taxpayer is unable to sign this application are \_\_\_\_\_

Signature of preparer other than taxpayer \_\_\_\_\_ Date \_\_\_\_\_

The Internal Revenue Service will indicate below whether the extension is granted or denied and return the original.

**Notice to Applicant—To Be Completed By the Internal Revenue Service**

- The application IS approved. (Please attach this form to the return.)
- The application IS NOT approved. Careful consideration has been given to the reasons stated in your application and it has been determined that the extension is not warranted.
- The application cannot be considered since it was filed after the due date of the return.
- Other \_\_\_\_\_

\_\_\_\_\_ Date \_\_\_\_\_

\_\_\_\_\_ Director  
 By \_\_\_\_\_

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If the original copy of this application is to be returned to the taxpayer at an address other than that shown on page 1, or to an agent acting for the taxpayer, please complete the section below:

Please Print or Type	Name
	Number and street
	City or town, State, and ZIP code

If possible, read Publication 54, Tax Guide for U.S. Citizens Abroad, before completing this application or filing your United States income tax return. You can get copies from offices of District Directors of Internal Revenue, from most United States embassies and consulates, or by writing to the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19155, U.S.A.

### Instructions

**Requirements for Filing.**—If you are a United States citizen (or a resident alien from a country whose income tax treaty with the United States qualifies you to the benefits of section 911(a)(2) of the Code to the same extent as a United States citizen) and you received earned income for personal services rendered in a foreign country or countries, you may obtain an extension of time to file your United States income tax return. You may be granted an extension to 30 days beyond the date upon which you can reasonably expect to qualify for the exemption of this earned income if you are either a bona fide resident of a foreign country or physically present in the foreign country for an 18-month period. An extension of time for filing is a privilege which will not be granted if your application is incomplete.

An extension of time to file a return, unless it specifies otherwise, does not extend the time for payment of the tax. The law imposes a penalty for the late payment of tax (other than estimated tax) of one-half percent a month or part of a month, unless you can show reasonable cause for failure to pay on time. Currently, interest accrues at the rate of 9 percent a year on any tax due from the regular due date of the return until payment is made. The law provides for periodic adjustments of the interest rate, which may be changed as early as February 1, 1976.

**Where to File.**—Complete in duplicate and file this application with either:

- The Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19155, or
- The local Internal Revenue Service Representative or other Internal Revenue Service Employee.

**Definition of Bona Fide Resident (Sec. 911(a)(1) of the Internal Revenue Code.)**—

(a) **General.**—If you are a United States citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year you may consider as exempt certain amounts of earned income derived from personal services rendered abroad. For each of the first three consecutive years of bona fide foreign residence, you may exclude no more than \$20,000 of earned income derived during each year. The maximum exclusion per year of bona fide foreign residence following the first

three consecutive years is \$25,000. There are certain conditions under which you may not consider earned income as exempt, regardless of your bona fide foreign residence status. Instructions under Special rules applicable to bona fide residence and physical presence cover these restrictions.

(b) **Determination of Residence.**—No specific rule can be stated for determining whether a United States citizen is a bona fide resident of a foreign country, since the determination involves your intentions regarding the length and nature of your stay. Your intention to establish a bona fide residence in a foreign country may be evidenced by words and acts, but where they conflict, more emphasis will be placed on the acts than on the words. Generally, if you go to a foreign country for a definite, but temporary purpose, and return to the United States after you have accomplished the purpose, you are not a bona fide resident of that foreign country. However, if an extended and indefinite stay is necessary for you to accomplish the purpose, and to that end you make your home in the foreign country, you may be a bona fide resident of the foreign country for Federal income tax purposes. The term "foreign country" does not include a possession of the United States.

(c) **Statement of Nonresidence.**—If you have earned income from a foreign country and you have indicated to the authorities of that country that you are not a resident there and so have not been subject to that country's income tax, you may not be treated as a bona fide resident of that foreign country. If you have made this statement and, as of any date a determination is being made about whether you qualify as a bona fide foreign resident, no adverse determination has been made by the authorities of the foreign country about your nonresidence status, you will be considered to have been held not subject to the income tax of that foreign country.

**Definition of those Physically Present in Foreign Countries (Sec. 911(a)(2) of the Internal Revenue Code.)**—

(a) **General.**—If you are a United States citizen (or a resident alien from a country whose income tax treaty with the United States qualifies you to the benefits of this section of the Code to the same extent it applies to United States citizens) physically present in a foreign country or countries for a total of at least 510 full days during any period of 18 consecutive months you may,

subject to the special rules set forth below, exclude up to \$20,000 of your earned income for each taxable year if the earned income is for services performed outside the United States and is attributable to the 18-month period.

(b) **Determination of 18-month Period and Application of 510-day Rule.**—In computing the minimum of 510 full days presence in any foreign country or countries, all separate periods of such presence during the 18-month period are to be totaled. The 510 full days need not be consecutive, but may be interrupted by periods during which you are traveling over international waters or are otherwise not present in a foreign country.

**Special Rules Applicable to Bona Fide Residence and Physical Presence.**—

(a) **Rule of Attribution.**—For purposes of determining the exemption, earned income (whether received before, during, or after the taxable year in which the services to which the amounts are attributable are performed) is considered received in the taxable year in which the services to which the amounts are attributable are performed. This rule applies only in determining the amount of the exemption and does not affect the time of reporting any amounts which are not exempt from tax. In no case will amounts be attributed to any year in which the services performed are insubstantial in nature.

(b) **Requirement as to Time of Receipt.**—To be exempt, earned income must be received before the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed.

(c) **Treatment of Amounts Paid by U.S. Government, etc.**—Earned income paid by the United States or any of its agencies or instrumentalities is not exempt from tax under the bona fide residence or physical presence tests.

**Requests for Any Other Reason.**—To request an extension for any reason other than the fact that you expect to qualify for exempt income earned abroad, you should file an application on Form 2688.

### Cautionary Note

The Internal Revenue Code provides for a penalty for underpayment of estimated tax. If you fail to qualify under either of the definitions stated above for excluding income from your return, you may be liable for this penalty. (See Publication 54)



# Exemption of Income Earned Abroad

▶ Attach to Form 1040.

For taxable year ending

**This Form is to be Used Only by United States Citizens and Certain Resident Aliens (See Instruction 1.)**

Name of taxpayer \_\_\_\_\_ Social security number \_\_\_\_\_

Foreign address (including Country) \_\_\_\_\_ Your occupation \_\_\_\_\_

Name of employer ▶ \_\_\_\_\_

Employer's address U.S. ▶ \_\_\_\_\_

Foreign ▶ \_\_\_\_\_

Give the latest year for which you filed a U.S. income tax return ▶ \_\_\_\_\_ Office where filed ▶ \_\_\_\_\_

For an explanation of the provisions under which earned income of citizens abroad is exempt, see instructions. You may obtain Publication 54, Tax Guide for U.S. Citizens Abroad, and all forms from any Internal Revenue office, U.S. Embassy, or Consulate.

Check status under which you claim exemption of earned income from services abroad

Bona fide residence. Complete Parts I and III

Physical presence. Complete Parts II and III

Complete all items in the parts pertaining to your status. If an item does not apply, write "DOES NOT APPLY." Failure to submit required information may result in disallowance of the claimed exemption.

## Part I To be Completed for Bona Fide Residence Only

1 Foreign country in which you claim bona fide residence \_\_\_\_\_ Residence began \_\_\_\_\_ (Date) ended \_\_\_\_\_ (Date)

2 Kind of living quarters in foreign country  Purchased house  Rented house or apartment  Rented room  Quarters furnished by employer

3 Did your family live with you abroad during any part of the taxable year?  Yes  No  
 If "Yes," for what period? \_\_\_\_\_

4 (a) Have you made a statement to the authorities of the foreign country you claim bona fide residence in that you are not a resident of that country?  Yes  No

(b) Are you required to pay income tax to the country you claim bona fide residence in?  Yes  No  
 If you made a statement to the authorities of the foreign country that you are not a resident and the country holds you are not subject to its income tax, you do not qualify for this U.S. exemption (See Instruction 1(b).)

5 Complete the following for days present in the U.S. or its possessions during the taxable year

Date arrived in U.S.	Date departed from U.S.	Number of days in U.S. on business	Amount earned in U.S. on business (Attach statement showing computation)	Date arrived in U.S.	Date departed from U.S.	Number of days in U.S. on business	Amount earned in U.S. on business (Attach statement showing computation)

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6 (a) State any contractual terms or other conditions relating to the length of your employment abroad. \_\_\_\_\_

(b) State the type of visa you entered the foreign country under \_\_\_\_\_

(c) Did your visa contain any limitations as to the length of your stay or employment in a foreign country?  Yes  No  
 If "Yes," attach explanation. \_\_\_\_\_

(d) List the places where you have resided and the dates of residence since you left the United States to establish residence abroad. \_\_\_\_\_

(e) Did you maintain a home in the United States while residing abroad?  Yes  No  
 If "Yes," show address of your home, whether it was rented, and the names and relationships of the occupants. \_\_\_\_\_

## Part II To be Completed for Physical Presence Only

7 The 18-month period the exemption for physical presence in a foreign country is based on is from \_\_\_\_\_ through \_\_\_\_\_

8 Enter all travel abroad during the 18 month period the exemption is based on, except travel between foreign countries that did not involve travel on or over international waters for 24 hours or more. If the last entry is an arrival in a foreign country, insert number of full days to end of 18 month period. If there was no travel to report during the period, write in schedule that you were physically present in a foreign country or countries during the entire 18-month period.

Name of country (including U.S.)	Date and time departed	Date and time arrived	Full days present in country	Number of days in U.S. on business	Amount earned in U.S. on business (Attach statement showing computation)

9 Enter prior years you claimed exemption for income earned abroad under section 911 ▶ \_\_\_\_\_

**Part III To be Completed for Both Bona Fide Residence and Physical Presence**

**10** Enter below your total earned income, including noncash remuneration. (See instructions 7 and 8(d))  
 Is part of the income (such as bonuses) attributable to services performed in past years or to be performed for years other than this year?  Yes  No  
 If "Yes," see Instructions 10(a) and 11

Do not report exempt income on your Form 1040, but enter all taxable income in the appropriate sections of the form. If you received all or part of your income in foreign currency, translate its exchange value into terms of U.S. dollars at the rates prevailing at the time you actually or constructively received the income.

Earned Income (for personal services rendered in foreign countries)	Exchange rates used	Amount (In U.S. dollars)
<b>11</b> (a) Total wages, salaries, bonuses, commissions, etc., received during this year . . . . .		
(b) Amount attributable to prior years or future years (See Instructions 10(a) and 11)		
(c) Balance attributable to this year. (Subtract line 11(b) from line 11(a)) . . . . .		
<b>12</b> Pensions and annuities (See instruction 10(d)) . . . . .		
<b>13</b> Allowable share of income for personal services rendered (See Instruction 7 and 10a)		
(a) In a business (including farming) or profession. (Attach Schedule C or F)		
(b) In a partnership (Give name, address, and nature of income.)		
.....		
.....		
<b>14</b> Noncash remuneration (Market value of property or facilities furnished by employer. Attach statement showing how determined)		
(a) Home . . . . .		
(b) Car . . . . .		
(c) Other property facilities (Specify) . . . . .		
.....		
<b>15</b> Other income (Specify) . . . . .		
.....		
<b>16</b> Allowances or reimbursements		
(a) Cost of living . . . . .		
(b) Overseas differential . . . . .		
(c) Family . . . . .		
(d) Education . . . . .		
(e) Home leave . . . . .		
(f) Quarters . . . . .		
(g) For any other purpose (Specify) . . . . .		
.....		
<b>17</b> Total earned income from sources outside the U.S. . . . .		
<b>18</b> Amount exempt (If exempt status changed during the taxable year, complete schedule below)		
<b>19</b> Taxable income (Line 17 less line 18. If less than zero enter zero. Enter here and report on Form 1040)		

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**Schedule for Computation of Exemption Claimed in Part III, line 18, above.**  
 (The \$20,000 and \$25,000 exemptions are for full taxable years. Prorate them if your exempt status changes during the taxable year. See Instructions 8(a)(ii) and 10(c).)

	A	B
<b>20</b> Applicable exemption . . . . .	\$20,000	\$25,000
<b>21</b> Number of exemption qualifying days in taxable year . . . . .		
<b>22</b> Total number of days in taxable year . . . . .		
<b>23</b> Percentage applicable (Divide the number of days on line 21 by the number of days on line 22)	%	%
<b>24</b> Allowable exemption (Multiply the amount on line 20 by the percent on line 23)	\$	\$
<b>25</b> Total allowable exemption (Add amounts on line 24 columns A and B. Enter here and on line 18)		\$

*(If more space is needed for any schedule, etc., attach statement)*

# Application for Automatic Extension of Time to File U.S. Individual Income Tax Return

**1975**

**NOTE:** Prepare this form in duplicate. File the original with the Internal Revenue Service Center where you are required to file your income tax return and pay the amount shown on line 6 below. Attach the duplicate to the face of your Form 1040. This is not an extension of time for payment of tax. The law imposes a penalty for late payment of tax unless you show reasonable cause for failure to pay when due. (See Instruction F.)

Please Print or Type	Name (if joint return, give first names and initials of both)	Last name	Your social security number
	Present home address (Number and street, including apartment number, or rural route)		Spouse's social security number
	City, town or post office State and ZIP Code		

An automatic 2 month extension of time until June 15, 1976, is hereby requested in which to file Form 1040 for the calendar year 1975 (or if a fiscal year return until \_\_\_\_\_, 19\_\_\_\_, for the taxable year beginning 1975, and ending \_\_\_\_\_, 1976).

1 Total tax you expect to owe for 1975 (see Form 1040, line 20)		
2 Federal income tax withheld		
3 1975 Estimated tax payments (include 1974 overpayment allowed as a credit)		
4 Other payments (see Form 1040, line 68)		
5 Total (add lines 2, 3, and 4)		
6 <b>BALANCE DUE</b> (subtract line 5 from line 1). Pay in full with this application		

**Signature and Verification**

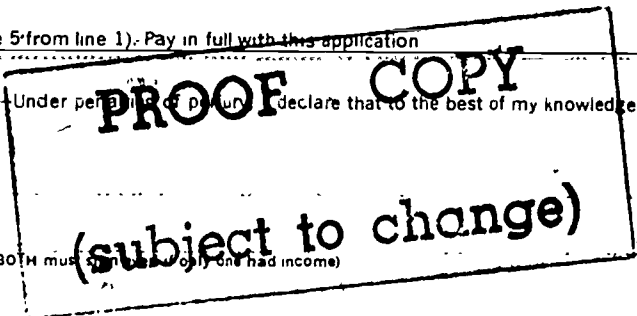
If Prepared by Taxpayer—Under penalties of perjury, I declare that to the best of my knowledge and belief, the statements made herein are true and correct.

Your signature

Date

Spouse's signature (if filing jointly, BOTH must sign, even if only one had income)

Date



If Prepared by Someone Other Than Taxpayer.—Under penalties of perjury, I declare that to the best of my knowledge and belief, the statements made herein are true and correct, that I am authorized by the taxpayer to prepare this application, and that I am:

- A member in good standing of the bar of the highest court of (specify jurisdiction)
- A certified public accountant duly qualified to practice in (specify jurisdiction)
- A person enrolled to practice before the Internal Revenue Service
- A duly authorized agent holding a power of attorney with respect to filing an extension of time. (The power of attorney need not be submitted unless requested.)
- A person standing in close personal or business relationship to the taxpayer who is unable to sign this application because of illness, absence, or other good cause. My relationship to the taxpayer and the reasons why the taxpayer is unable to sign this application are \_\_\_\_\_

Signature of preparer other than taxpayer

Date

See instructions on reverse

# Moving Expense Adjustment

**1975**

▶ Attach to Form 1040.

Name(s) as shown on Form 1040

Social security number

- (a) What is the distance from your former residence to your new business location? \_\_\_\_\_ miles
- (b) What is the distance from your former residence to your former business location? \_\_\_\_\_ miles
- (c) If the distance in (a) is 50 or more miles farther than the distance in (b), complete the rest of this form. If the distance is less than 50 miles, you are not entitled to a moving expense deduction. (See instruction A.)

1 Transportation expenses in moving household goods and personal effects . . . . .		
2 Travel, meals, and lodging expenses in moving from former to new residence . . . . .		
3 Pre-move travel, meals, and lodging expenses in searching for a new residence after obtaining employment . . . . .		
4 Temporary living expenses in new location or area during any 30 consecutive days after obtaining employment . . . . .		
5 Total (Add lines 3 and 4.) . . . . .		
6 Enter the lesser: Line 5 or \$1,000 (\$500 if married, filing a separate return, and you resided with your spouse who also started work during the taxable year) . . . . .		
7 Expenses incident to: (Check one.)		
(a) <input type="checkbox"/> sale or exchange of your former residence; or,		
(b) <input type="checkbox"/> if nonowner, settlement of your unexpired lease on former residence . . . . .		
8 Expenses incident to: (Check one.)		
(a) <input type="checkbox"/> purchase of a new residence; or,		
(b) <input type="checkbox"/> if renting, acquiring a new lease . . . . .		
9 Total (Add lines 6, 7, and 8.) . . . . .		
<p>Note: If you use the amounts shown on line 7(a) or 8(a) as part of your moving expense and line 9 exceeds \$2,500 (\$1,250 if married, filing a separate return, and you resided with your spouse who also started to work during the taxable year), you may reduce line 7(a) or 8(a) by the excess. Consider the reduction a decrease in realized gain on the sale of your residence or as an increase in the basis of your new residence, or both.</p>		
10 Enter the lesser: Line 9 or \$2,500 (\$1,250 if married, filing a separate return, and you resided with your spouse who also started work during the taxable year). (See instruction C(2).) . . . . .		
11 Total moving expenses (Add lines 1, 2, and 10.) . . . . .		
12 Reimbursements and allowances received for this move (other than amounts included on Form W-2) (See instruction L.) . . . . .		
13 If line 12 is less than line 11, enter the excess here and on Form 1040, line 38 . . . . .		
14 If line 12 is larger than line 11, enter the excess here and on Form 1040, line 35, as "Excess moving reimbursement" . . . . .		

## Instructions

**A. Who May Deduct Moving Expenses.**—As an employed or a self-employed person, you may deduct reasonable moving expenses paid or incurred during the taxable year in connection with a move you make to a new principal work place.

The deduction is allowable to you only if (a) your change in job location has added at least 50 miles to the distance from your old residence to your work, or (b) if you had no former principal work place, your new principal work place is at least 50 miles from your former residence. (The distance between two points is considered to be the

shortest of the more commonly traveled routes between those points.)

Also, the deduction is allowable only if either (a) during the 12 months immediately following your arrival in the general location of your new principal work place you are a full-time employee during at least 39 weeks, or (b) during the 24 months immediately following such arrival you are a full-time employee or self-employed on a full-time basis during at least 78 weeks, of which not less than 39 weeks are during the 12 months following your arrival.

**B. The 39 Week/78 Week Test.**—Disregard the 39 week/78 week test referred to in instruction A if employment is terminated because of death, disability, involuntary separation (other than for willful misconduct), or transfer for the employer's benefit.

If you have not satisfied the 39 week/78 week test before time for filing your return for the taxable year in which you paid or incurred the moving expenses, but believe you will later satisfy it, you may still deduct those expenses in the year you paid or incurred them.

(Continued on back)

If, however, you have not satisfied the 39 week/78 week test at the close of your next taxable year you must include an amount equal to the deduction for moving expenses taken in the prior year, in income you report for that next year, unless you file an amended return to eliminate the deduction for the year you claimed it

#### C. Deductible Moving Expenses.—

(1) Expenses Not Subject to a Dollar Limitation, lines 1 and 2—These are

(a) Expenses for moving household goods and personal effects from your former to your new residence, and

(b) Travel expenses (including meals and lodging) from your former to your new residence (not to be confused with other travel expenses, explained below)

(2) Expenses Subject to a Dollar Limitation, lines 3, 4, 7, and 8—These are

(a) Travel expenses (including meals and lodging), after you obtain employment, from your former residence to the general location of your new principal work place and return, primarily to find a new residence

(b) Meals and lodging expenses while occupying temporary quarters in the general location of your new principal work place during any 30 consecutive days after you obtain employment, and

(c) Qualified expenses attributable to the sale, purchase, or lease of your residence

These C(2) expenses cannot exceed \$2,500 overall per move, of which the C(2) (a) and (b) expenses cannot exceed \$1,000.

If you and your spouse both begin work at new principal work places during the taxable year, consider the two events as one when assigning the dollar limitations in C(2) if, at the end of the taxable year, you have shared the same new residence. If you file separate returns, these expenses are limited to \$1,250 overall per move for each of you, and the C(2)(a) and (b) expenses cannot exceed \$500 for each of you

However, if you and your spouse have not shared the same new residence nor made specific plans to do so within a determinable time, consider the events separately. If you file separate returns, these expenses are limited to \$2,500 overall per move, and the C(2)(a) and (b) expenses cannot exceed \$1,000. If you file a joint return, these expenses are limited to \$5,000 overall per move, and the C(2)(a) and (b) expenses cannot exceed \$2,000

D. Reasonable Moving Expenses.—The term "moving expenses" includes only those expenses that are reasonable under the particular move's circumstances. Ex-

penses related to your household members include only those for members who had and have both your former and new residences, respectively, as their principal abodes (A servant, governess, chauffeur, nurse, or valet is not generally considered to be a member of your household)

E Household Goods and Personal Effects.—In your expenses of moving household goods and personal effects from your former to your new residence, include the actual cost of transportation or hauling, packing and crating, in transit storage, and insurance

F. Travel Expenses from Former Residence to New Residence.—These include the cost of transportation, meals, and lodging (including costs for your arrival date). The deduction for travel expenses from your former to your new residence is allowable for only one trip. However, it is not necessary that you and all members of your household travel together and at the same time. (To compute the cost of transportation if you use your own car, see instruction G, below)

G. Travel Expenses (after obtaining employment) From Former Residence to General Location of New Principal Work Place and Return, for Purpose of Searching for a New Residence.—Travel expenses are deductible only if (1) you begin the trip to the general location of your new principal work place after you have obtained employment, (2) you return to your former residence after searching for a new residence in the general location of your new principal work place, and (3) your principal purpose in traveling to the general location of the new principal work place is to search for a new residence

Your deduction for travel expenses for the principal purpose of looking for a new residence is not limited to any number of trips by you and your household members. Moreover, to be deductible, a trip need not result in a lease or purchase of property

If you use your own automobile for this transportation, you may compute the transportation expenses in either of two ways. (1) actual out of pocket expenses (for example, gasoline, oil, repairs), or (2) at a rate of seven cents a mile. If you claim out of pocket expenses, keep an adequate record to verify amounts, if you use the seven cents a mile method, attach a schedule to verify the mileage

H. Meals and Lodging Expenses While Occupying Temporary Quarters.—These are deductible for any 30 consecutive days after you have obtained employment in the general location of your new principal work place.

I. Qualified Expenses Attributable to the Sale, Purchase, or Lease of a Residence.—

This term means only those reasonable expenses (such as sales commissions, advertising expenses, attorney's and legal fees, title fees, escrow fees, and State transfer taxes) incident to (a) the sale or exchange of your former residence (not including expenses for work performed on the residence to assist in its sale) which would be taken into account in determining the amount realized on the sale or exchange, (b) your purchase of a new residence which otherwise would be included in (i) the adjusted basis of your new residence, or (ii) the cost of the loan (but not including payments or prepayments of interest), (c) the settlement of an unexpired lease on your former residence, or (d) your acquisition of a lease on your new residence (excluding payments or prepayments of rent)

J. Nondeductible Expenses.—Moving expenses do not include, for example, any loss incurred on the sale, exchange, or other disposition of property mortgage penalties, cost of refitting rugs or draperies, losses due to the disposal of memberships in clubs, tuition or similar items

K. Self-employed Individuals.—A self employed individual is one who performs personal services as (a) the owner of the entire interest in an unincorporated trade or business, or (b) a partner in a partnership operating a trade or business

To deduct expenses on lines 3 and 4 as a self employed person, you have met the condition of having obtained employment if you have made substantial arrangements to commence work.

L. Reimbursements and Allowances.—Include all reimbursements and allowances for moving expenses in income. In general, you will find such reimbursements and allowances included on your Form W-2. However, if there is doubt, check with your employer. Use line 12 for reporting reimbursements and allowances if they are not included elsewhere on Form 1040 or related schedules

M. No Double Benefits Allowable.—You cannot reduce the amount realized on the sale of your old residence by any expenses which become part of your moving expense deduction on line 7. You cannot increase the basis of your new residence by the amount of any expenses which become part of your moving expense deduction on line 8. If you include such expenses in income because you have not met some condition for the allowance of this deduction, make an appropriate adjustment to the selling price or basis

N. Publication 521.—For additional information, you may obtain Publication 521, Tax information on Moving Expenses, free at Internal Revenue Service offices.