Solutions Manual for South Western Federal Taxation 2019 Comprehensive 42nd Maloney

SWFT 2019 Comprehensive Volume
Chapter 2: Working with the Tax Law
End-of-Chapter Question, Exercise, and Problem Correlations

Comprehensive 41e (2018)	Comprehensive 42e (2019)	Comprehensive (2019) Learning Objectives	Exact Same	Revised	Brand New	Source Volume: Ind. Income Taxes 42e (2019) OR Corporations 42e (2019)	Source Volume Chapter	Source Volume Question, Problem, or Exercise #
Discussion Questions (DQ)								
DQ.02.01	DQ.02.01	LO1	x			V1	2	DQ1
DQ.02.02	DQ.02.02	LO1	x			V1	2	DQ2
DQ.02.03	DQ.02.03	LO1	x			V1	2	DQ3
DQ.02.04	DQ.02.04	LO2, 5		x		V1	2	DQ4
DQ.02.05	DQ.02.05	LO1, 2	x			V1	2	DQ5
DQ.02.06	DQ.02.06	LO1	x			V1	2	DQ6
DQ.02.07	DQ.02.07	LO1, 4	x			V1	2	DQ7
DQ.02.08	DQ.02.08	LO1	x			V1	2	DQ8
DQ.02.09	DQ.02.09	LO1, 5	x			V1	2	DQ9
DQ.02.10	DQ.02.10	LO1	x			V1	2	DQ11
DQ.02.11	DQ.02.11	LO1	x			V1	2	DQ13
DQ.02.12	DQ.02.12	LO1	x			V1	2	DQ14
DQ.02.13	DQ.02.13	LO1, 5	x			V1	2	DQ15
DQ.02.14	DQ.02.14	LO1	x			V1	2	DQ16
DQ.02.15	DQ.02.15	LO1	x			V1	2	DQ17
DQ.02.16	DQ.02.16	LO1	x			V1	2	DQ18
DQ.02.17	DQ.02.17	LO1	x			V1	2	DQ21
DQ.02.18	DQ.02.18	LO1	x			V1	2	DQ22
DQ.02.19	DQ.02.19	LO1	x			V1	2	DQ23
DQ.02.20	DQ.02.20	LO1, 4	x			V1	2	DQ24
DQ.02.21	DQ.02.21	LO2	x			V1	2	DQ25
DQ.02.22	DQ.02.22	LO2	x			V1	2	DQ26
DQ.02.23	DQ.02.23	LO2	x			V1	2	DQ27
DQ.02.24	DQ.02.24	LO2	x			V1	2	DQ28
DQ.02.25	DQ.02.25	LO2	x			V1	2	DQ29
DQ.02.26	DQ.02.26	LO2	x			V1	2	DQ30
DQ.02.27	DQ.02.27	LO3	x			V1	2	DQ32
DQ.02.28	DQ.02.28	LO4	x			V1	2	DQ33
DQ.02.29	DQ.02.29	LO2, 4	x			V1	2	DQ34
DQ.02.30	DQ.02.30	LO6	x			V1	2	DQ35

Comprehensive 41e (2018)	Comprehensive 42e (2019)	Comprehensive (2019) Learning Objectives	Exact Same	Revised	Brand New	Source Volume: Ind. Income Taxes 42e (2019) OR Corporations 42e (2019)	Source Volume Chapter	Source Volume Question, Problem, or Exercise #
DQ.02.31	DQ.02.31	LO7	x			V1	2	DQ 36
Computational Exercises (EX)								
N/A								
Problems (PR)								
PR.02.32	PR.02.32	LO1	x			V1	2	PR37
PR.02.33	PR.02.33	LO1, 4	x			V1	2	PR40
PR.02.34	PR.02.34	LO4		x		V1	2	PR41
PR.02.35	PR.02.35	LO1, 2		x		V1	2	PR42
PR.02.36	PR.02.36	LO6		x		V1	2	PR43
Cumulative (Tax Return) Problems (CP)								
N/A								
Research Problems (RP)								
RP.02.01	RP.02.01		x			V1	2	RP 1
RP.02.02	RP.02.02		x			V1	2	RP 3
RP.02.03	RP.02.03		x			V1	2	RP 4
RP.02.04	RP.02.04		x			V1	2	RP 5
RP.02.05	RP.02.05			x		V1	2	RP 6
Becker CPA Review Questions (BCPA)								
N/A								

CHAPTER 2

WORKING WITH THE TAX LAW

SOLUTIONS TO PROBLEM MATERIALS

DISCUSSION QUESTIONS

1. (LO 1) Determining the intent of Congress is a large part of tax research.

2. (LO 1) The many gray areas, the complexity of the tax laws, and the possibility of different interpretations of the tax law create the necessity of alternatives for structuring a business transaction.

3. (LO 1) Federal tax legislation generally originates in the House Ways and Means Committee.

4. (LO 2, 5) Maloney, Raabe, Hoffman, & Young, CPAs
5191 Natorp Boulevard
Mason, OH 45040

October 26, 2018

Ms. Sonja Bishop
Tile, Inc.
100 International Drive
Tampa, FL 33620

Dear Ms. Bishop:

This letter is in response to your request about information concerning a conflict between a U.S. treaty with Spain and a section of the Internal Revenue Code. The major reasons for treaties between the United States and certain foreign countries is to eliminate double taxation and to render mutual assistance in tax enforcement.

Section 7852(d) provides that if a U.S. treaty is in conflict with a provision in the Code, neither will take general precedence. Rather, the more recent of the two will have precedence. In your case, the Spanish treaty takes precedence over the Code section.

A taxpayer must disclose on the tax return any positions where a treaty overrides a tax law. There is a $1,000 penalty per failure to disclose for individuals and a $10,000 penalty per failure for corporations.

Should you need more information, feel free to contact me.

Sincerely,

Alice Hanks, CPA
Tax Partner

5. (LO 1, 2) Income tax

Reg. § 1. 163–10 (a) (2)

Type of Regulation
Related Code Section
Regulation Number
Regulation Paragraph
Regulation Subparagraph

6. (LO 1) Notice 90–20 is the 20th Notice issued during 1990, and it appears on page 328 of Volume 1 of the *Cumulative Bulletin* in 1990.

7. (LO 1, 4) The items would probably be ranked as follows (from lowest to highest):

   (1) Letter ruling (valid only to the taxpayer to whom issued).

   (2) Proposed Regulation (most courts ignore these).

   (3) Revenue Ruling.

   (4) Interpretive Regulation.

   (5) Legislative Regulation.

   (6) Internal Revenue Code.

8. (LO 1)
   a. This citation refers to a Temporary Regulation; 1 refers to the type of Regulation (i.e., income tax), 956 is the related Code section number, 2 is the Regulation section number, and T refers to temporary.

   b. Revenue Ruling number 15, appearing on page 975 of the 23rd weekly issue of the *Internal Revenue Bulletin* for 2012.

   c. Letter Ruling 51, issued in the 4th week of 2002.

9. (LO 1, 5) TAX FILE MEMORANDUM

   DATE: September 24, 2018

   FROM: George Ames

   SUBJECT: Telephone conversation with Sally Andrews on applicability of 2007 letter ruling

   I told Sally Andrews that only the taxpayer to whom the 2007 letter ruling was issued may rely on the pronouncement. I stressed that a letter ruling has no precedential value under § 6110(k)(3).

   I pointed out that a letter ruling indicates the position of the IRS on the specific fact pattern present as of the date of the letter ruling. As such, a letter ruling is not primary authority. However, under Notice 90–20, 1990–1 C.B. 328, a letter ruling is substantial authority for purposes of the accuracy-related penalty in § 6662.

10. (LO 1) Letter rulings may be found in:

- *IRS Letter Ruling Reports* (CCH).
- Bloomberg BNA *Daily Tax Reports*.
- *Tax Notes* (Tax Analysts).
- Letter rulings are also available in electronic (online) tax research services (like Thomson Reuters *Checkpoint*).

11. (LO 1) Dwain must consider several factors in deciding whether to take the dispute to the judicial system:

- How expensive will it be?
- How much time will be consumed?
- Does he have the temperament to engage in the battle?
- What is the probability of winning?
- Once a decision is made to litigate the issue, the appropriate judicial forum must be selected.
- Tax Court judges have more expertise in tax matters.
- The tax deficiency need not be paid to litigate in the Tax Court. However, if Dwain loses, interest must be paid on any unpaid deficiency.
- If a trial by jury is preferred, the U.S. District Court is the appropriate forum.
- The tax deficiency must be paid before litigating in the District Court or the Court of Federal Claims.
- If an appeal to the Federal Circuit is important, Dwain should select the Court of Federal Claims.
- A survey of the decisions involving the issues in dispute is appropriate. If a particular court has taken an unfavorable position, that court should be avoided.

12. (LO 1) The main advantage of the U.S. Court of Federal Claims occurs when a taxpayer's applicable Circuit Court previously rendered an adverse decision. Such a taxpayer may select the U.S. Court of Federal Claims because any appeal will be to the Federal Circuit.

    One disadvantage of the U.S. Court of Federal Claims is that the tentative deficiency must be paid before the Court will hear and decide the controversy.

    The U.S. Court of Federal Claims is a trial court that usually meets in Washington, D.C. It has jurisdiction for any claim against the United States that is based on the Constitution, any Act of Congress, or any Regulation of an executive department.

13. (LO 1, 5)

Maloney, Raabe, Hoffman, & Young, CPAs
5191 Natorp Boulevard
Mason, OH 45040

July 9, 2018

Mr. Eddy Falls
200 Mesa Drive
Tucson, AZ 85714

Dear Mr. Falls:

You have three alternatives should you decide to pursue your $229,030 deficiency in the court system. One alternative is the U.S. Tax Court, the most popular forum. Overall, Tax Court judges have more expertise in tax matters. The main advantage is that the U.S. Tax Court is the only trial court where the tax need not be paid prior to litigating the controversy. However, interest will be due on an unpaid deficiency. The interest rate varies from one quarter to the next as announced by the IRS.

One disadvantage of the U.S. Tax Court is the delay that might result before a case is decided. The length of delay depends on the Court calendar, which includes a schedule of locations where cases will be tried. Another disadvantage is being unable to have the case heard before a jury.

The major advantage of another alternative, the U.S. District Court, is the availability of a trial by jury. One disadvantage of a U.S. District Court is that the tentative tax deficiency must be paid before the Court will hear and decide the controversy.

The Court of Federal Claims, the third alternative, is a trial court that usually meets in Washington, D.C. It has jurisdiction for any claim against the United States that is based on the Constitution, any Act of Congress, or any regulation of an executive department. The main advantage of the U.S. Court of Federal Claims occurs when a taxpayer's applicable Circuit Court previously rendered an adverse decision. Such a taxpayer may select the Court of Federal Claims because any appeal will be to the Federal Circuit instead. One disadvantage of the Court of Federal Claims is that the tentative deficiency must be paid before the Court will hear and decide the controversy.

I hope this information is helpful, and should you need more help, please contact me.

Sincerely,

Agnes Reynolds, CPA
Tax Partner

14. (LO 1) The U.S. Tax Court hears only tax cases and is the most popular forum for tax cases (generally viewed as an advantage). Overall, Tax Court judges have more tax expertise; many had careers in the Treasury Department or the IRS before being appointed to the Tax Court. A taxpayer does not have to pay the tax deficiency assessed by the IRS before trial, but a taxpayer may deposit a cash bond to stop the running of interest (also viewed as an advantage). Appeals from a Tax Court are to the appropriate U.S. Court of Appeals. A disadvantage is that the taxpayer may not obtain a jury trial in the U.S. Tax Court.

15. (LO 1) See Exhibit 2.4, Exhibit 2.5, and Concept Summary 2.1.
    a. There is no appeal by either the taxpayer or the IRS from a decision of the Small Cases Division of the U.S. Tax Court.

    b. The first appeal would be to the Sixth Circuit Court of Appeals. Further appeal would be to the U.S. Supreme Court.

    c. Same as part b. above.

    d. The appeal would be to the Federal Circuit Court of Appeals and then to the U.S. Supreme Court.

16. (LO 1) The term *petitioner* is a synonym for plaintiff, which refers to the party requesting action in a court.

17. (LO 1) See Exhibit 2.5.
    a. Tenth.

    b. Eighth.

    c. Ninth.

    d. Fifth.

    e. Seventh.

18. (LO 1) See Exhibit 2.4.
    a. The Tax Court must follow its own cases, the pertinent U.S. Circuit Court of Appeals, and the Supreme Court.

    b. The Court of Federal Claims must follow its own decisions, the Federal Circuit Court of Appeals, and the Supreme Court.

    c. The District Court must follow its own decisions, the pertinent U.S. Circuit Court of Appeals, and the Supreme Court.

19. (LO 1) The appropriate Circuit Court of Appeals for an appeal depends on where the litigation originated. For example, an appeal from Texas would go to the Fifth Circuit Court of Appeals and an appeal from Colorado would go to the Tenth Circuit Court of Appeals. See Exhibit 2.5.

20. (LO 1, 4)
    a. If the taxpayer chooses a U.S. District Court as the trial court for litigation, the U.S. District Court of Wyoming will be the forum to hear the case. Unless the prior decision has been reversed on appeal, one would expect the same court to follow its earlier holding.

    b. If the taxpayer chooses the U.S. Court of Federal Claims as the trial court for litigation, the decision that was rendered previously by this Court should have a direct bearing on the outcome. If the taxpayer selects a different trial court (i.e., the appropriate U.S. District Court or the U.S. Tax Court), the decision that was rendered by the U.S. Court of Federal Claims will be persuasive but not controlling. It is, of course, assumed that the result that was reached by the U.S. Court of Federal Claims was not reversed on appeal.

c. The decision of a U.S. Circuit Court of Appeals will carry more weight than one that was rendered by a trial court. Because the taxpayer lives in California, however, any appeal from a U.S. District Court or the U.S. Tax Court will go to the Ninth Circuit Court of Appeals (see Exhibit 2.4). Although the Ninth Circuit Court of Appeals might be influenced by what the Second Circuit Court of Appeals has decided, it is not compelled to follow such holding. See Exhibit 2.5.

d. Because the U.S. Supreme Court is the highest appellate court, one can place complete reliance upon its decisions. Nevertheless, one should investigate any decision to see whether the Code has been modified with respect to the result that was reached. The rare possibility also exists that the Court may have changed its position in a later decision. See Exhibit 2.4.

e. When the IRS acquiesces to a decision of the U.S. Tax Court, it agrees with the result that was reached. As long as such acquiescence remains in effect, taxpayers can be assured that this represents the position of the IRS on the issue that was involved. Keep in mind, however, that the IRS can change its mind and can, at any time, withdraw the acquiescence and substitute a nonacquiescence.

f. The issuance of a nonacquiescence usually reflects that the IRS does not agree with the result reached by the U.S. Tax Court. Consequently, taxpayers are placed on notice that the IRS will continue to challenge the issue that was involved.

21. (LO 2) The number 66 is the volume number for the U.S. Tax Court, 39 refers to the page number of the 562nd volume of the *Federal Second Series*, and *nonacq.* means that the IRS disagreed with the decision. The Tax Court (T.C.) cite is to the trial court.

22. (LO 2) There is no automatic right of appeal to the U.S. Supreme Court. Appeal is by Writ of Certiorari. If the Court agrees to hear the dispute, it will grant the Writ (*Cert. granted*). Most often, the highest court will deny jurisdiction (*Cert. denied*).

23. (LO 2)
a. Ninth Circuit Court of Appeals.

b. U.S. Tax Court.

c. U.S. Supreme Court.

d. Bureau of Tax Appeal (old name of U.S. Tax Court).

e. Tax Court (memorandum decision).

f. Court of Claims.

g. Not a court decision.

h. District Court in New York.

i. Not a court decision.

24. (LO 2) See Concept Summary 2.2.
a. This citation is to a regular decision of the U.S. Tax Court that was issued in 1950. The decision can be found in Volume 14, page 74, of the *Tax Court of the United States Report*, published by the U.S. Government Printing Office.

b. This citation is for a decision of the U.S. Fifth Circuit Court of Appeals that was rendered in 1979. The decision can be found in Volume 592, page 1251, of the *Federal Reporter*, Second Series (F. 2d), published by West Publishing Company.

c. This citation is for a decision of the U.S. Sixth Circuit Court of Appeals that was rendered in 1995. The decision can be found in Volume 1 for 1995, paragraph 50,104 of *U.S. Tax Cases*, published by Commerce Clearing House.

d. This citation is for a decision of the U.S. Sixth Circuit Court of Appeals that was rendered in 1995. The decision can be found in Volume 75, page 110, of the *Second Series of American Federal Tax Reports*, published by RIA.

e. This citation is for a decision of the U.S. District Court of Texas that was rendered in 1963. The decision can be found in Volume 223, page 663, of the *Federal Supplement Series*, published by West Publishing Company.

25. (LO 2)
a. None.

b. USTC.

c. USTC.

d. USTC.

e. TCM.

26. (LO 2) Decisions of the U.S. Court of Federal Claims (formerly named the Claims Court) are published in the USTCs; the AFTRs; and the West Publishing Co. reporter called the *Federal Reporter*, *Second Series* (F.2d) (before October 1982) and the *Claims Court Reporter* (beginning October 1982 through October 30, 1992). The name of the U.S. Court of Federal Claims was changed from the Claims Court effective October 30, 1992. Currently, this court's decisions are published in the *Federal Claims Reporter*. See Concept Summary 2.2.

27. (LO 3) After understanding the relevant facts:

- Yvonne can begin with the index volumes of the available tax services: RIA, CCH, or BNA Portfolios.

- A key word search on an online service should be helpful—Thomson Reuters *Checkpoint*, CCH *IntelliConnect*, LexisNexis, or Westlaw (or WestlawNext).

- Yvonne may browse through IRS publications (available on the IRS website).

- Yvonne could consult CCH's *Federal Tax Articles* to locate current appropriate articles written about qualified stock options. Thomson Reuters publishes the *Index to Federal Tax Articles* that is organized using RIA's paragraph index system.

- Additional information can be found on the internet. The directory at **taxsites.com** may be useful.

28. (LO 4) The current Code can be found in various places. Several of the major tax services publish paperback editions of the Code (and Regulations). These editions are usually revised twice each year. An annotated and abridged version of the Code and Regulations is published annually by Cengage (by James E. Smith and Mark Altieri). Further, the text of the Code may be found in the major tax services and as Title 26 of the U.S. Code. The Code also may be found on the Web.

29. (LO 2, 4) The best means of locating tax articles pertinent to your problem is through Commerce Clearing House's *Federal Tax Articles*. This multivolume service includes a subject index, a Code section number index, and an author's index. Another is the *Index to Federal Tax Articles* (published

by Thomson Reuters). Both of these indexes are updated periodically, but are available only in print form.

Court decisions, revenue rulings and procedures, and other relevant authority may be reviewed for reliability by using a *citator* within the commercial tax service. A citator provides the history of a case, including the authority relied on (e.g., other judicial decisions) in reaching the result. Reviewing the references listed in the citator discloses whether the decision was appealed and, if so, with what result (e.g., affirmed, reversed, or remanded). It also reveals other cases with the same or similar issues and how they were decided. Thus, a citator reflects on the validity of a case and may lead to other relevant authority. If one intends to rely on a judicial decision to any significant degree, "running" the case through a citator is imperative.

30. (LO 6) The primary purpose of effective tax planning is to maximize the taxpayer's after-tax wealth. This process can entail an avoidance, a reduction, or a postponement of the tax until the future.

This process does not mean that the course of action selected must produce the lowest possible tax under the circumstances. Legitimate business goals also must be considered.

There is nothing illegal or immoral about tax avoidance. A citizen has every legal right to arrange his or her affairs to keep the attendant taxes as low as possible. One is required to pay no more taxes than the law demands. There is no difference between a tax adviser's reduction of a tax expense and a cost accountant's reduction of a cost of operating a business.

31. (LO 7) Simulations on the CPA exam are small case studies designed to test a candidate's tax knowledge and skills using real-life work-related situations. Simulations include a four-function, pop-up calculator, a blank spreadsheet with some elementary functionality, and authoritative excerpts that are necessary to complete the tax case study simulations (e.g., Internal Revenue Code and Federal tax forms). The AICPA made a number of changes to the CPA exam, including increasing the number of simulations, in 2017.

PROBLEMS

32. (LO 1)
    b. p. 2-5.

33. (LO 1, 4)
    a. Code section.
    b. Legislative Regulation.
    c. Recent Temporary Regulation.
    d. Interpretive Regulation.
    e. Revenue Ruling.
    f. Letter Ruling.
    g. Proposed Regulation.

34. (LO 4)
    a. P.
    b. P.
    c. P.
    d. S.
    e. P.
    f. S.
    g. P. Valid for three years.
    h. P.
    i. N.
    j P.

35. (LO 1, 2)
    a. CCH.
    b. RIA.
    c. U.S.
    d. CCH.
    e. U.S.
    f. RIA.
    g. W.
    h. W.
    i. W.
    j. W.
    k. U.S.
    l. O.

36. (LO 6)
    a. E.
    b. E.
    c. A.
    d. A.
    e. A.

RESEARCH PROBLEMS

1. a. *Higgens v. Comm*., 312 U.S. 212 (1941).

   b. *Talen v. U.S*., 355 F.Supp.2d 22 (D.Ct. D.C., D.D.C., 2004).

   c. Rev.Rul. 2008–18, 2008–13 I.R.B. 674.

   d. *Pahl v. Comm*., 150 F.3d 1124 (CA–9, 1998).

   e. *Veterinary Surgical Consultants PC*, 117 T.C. 141 (2001).

   f. *Yeagle Drywall Co*., T.C. Memo. 2001–284.

2. For the Oprah car giveaway, the 234 audience recipients who received keys to a car were taxed on the value of the car, which was in the $30,000 range. Because they were merely present in the audience, the fair market value was included in gross income under § 61.

   As for the World Furniture Mall promotion, the discount or rebate could be tax-free because a rebate of all or a portion of the purchase price of property generally does not result in gross income. The customer would have a zero basis in the furniture. Rev.Rul. 76–96, 1976–1 C.B. 23 and Rev.Rul. 88–95, 1988–2 C.B. 28. See "Furniture for Nothing and It's all Tax-Free," *Journal of Taxation*, December 2006, pp. 382 and 383.

3. There does not appear to be a clear-cut answer to this question. Section 104 allows exclusion from gross income for damages paid on account of physical injuries and physical sickness. However, the IRS requires observable bodily harm for an exclusion to be available (Ltr.Rul. 200041022).

   So is false imprisonment physical? In CCA 200809001, the IRS allowed an exclusion for a settlement with an institution for sexual abuse. However, the Tax Court in *Daniel and Brenda Stadnyk*, T.C. Memo. 2008–289 would not allow an exclusion for $49,000 received for about one day in a jail.

   Brenda Stadnyk was dissatisfied with an automobile purchase, so she placed a stop payment order on the check she tendered to the dealership. Bank One listed the reason for not paying the dealership as a "NSF check." The dealership then filed a criminal complaint against her for passing a worthless check. She spent about one day in a holding area in a county jail.

   In "Why False Imprisonment Recoveries Should Not Be Taxable," *Tax Notes*, June 8, 2009, pp. 1217–1220, Robert Wood provides a lengthy discussion of this problem.

Research Problems 4 and 5

These research problems require that students utilize online resources to research and answer the questions. As a result, solutions may vary among students and courses. You should determine the skill and experience levels of the students before assigning these problems, coaching where necessary. Encourage students to use reliable websites and blogs of the IRS and other government agencies, media outlets, businesses, tax professionals, academics, think tanks, and political outlets to research their answers.

4. (1) Go to the website, click on the Internal Revenue Code link, click on Subtitle A, and scroll down to Sec. 61. This section defines gross income broadly. In addition to the 15 items specifically listed as income, Sec. 61 directs the reader to other IRC sections and indicates that the list of income items is not all-inclusive. In general, the IRC takes a broad view of income; everything is income unless an IRC section specifies that the amount is not income.

   (2) To find the case, go to the website and click on the US Tax Court link on the left side of the page. Enter the name Mark Spitz in the search bar.

   a. The tax years are 2001 and 2002, as indicated in the first sentence of the case, not 2006, the year in the citation, which is the year the case was decided.
   b. As noted above, 2006.
   c. The court decided in favor of the IRS.
   d. At the end of the decision, the penalty in § 6662 is discussed. This section imposes a 20% accuracy-related penalty on any portion of a tax liability underpayment (the situation in which Mr. Spitz found himself) attributable to a substantial understatement of income tax. Mr. Spitz was found not liable for the penalty because the court indicated that he was unsophisticated in tax law and had relied on a competent adviser to prepare his return.

5. a. On the “Opinions Search” tab, review the “Opinion Type” choices.
   b./c. On the “Opinions Search” tab, select the appropriate opinion type, and enter a common last name in the “Case Name Keyword” bar.
   d. Click on the Rules tab on the upper left side of the page.
   e. The student e-mail should summarize the items above. Look for proper grammar and e-mail etiquette in addition to the correct answer.

SOLUTION TO ETHICS & EQUITY FEATURE

Reporting Tax Fraud (p. 2-7). Most individuals probably believe that it is ethical to report tax fraud. A 2014 IRS Oversight Board survey indicated that 86 percent of Americans believed that it was “not acceptable at all to cheat on taxes.” On the other hand, that same survey indicated that 11 percent of taxpayers said that some cheating on their taxes was acceptable.

A number of organizations (including the IRS) provide estimates of the “tax gap,” with the most recent IRS estimates indicating that the gross tax gap is around $458 billion, with $58 billion being collected eventually. The IRS divides the net gap into $291 billion by individuals, $35 billion by corporations, $79 billion by employment taxes, and $1 billion by estate and excise taxes.

NOTES

CHAPTER 2

WORKING WITH THE TAX LAW

LECTURE NOTES

OVERVIEW

Federal tax law is a mixture of statutory provisions, administrative pronouncements, and court decisions. Anyone who has attempted to work with this body of knowledge is familiar with its complexity. Tax research provides the vehicle by which one makes sense out of this complexity.

SUMMARY OF CHANGES IN THE CHAPTER

The following are notable changes in the chapter from the 2018 Edition. For major changes, see the Preface of the text.

- Created new Big Picture example and updated related examples throughout the chapter.
- Revised text to reflect Tax Cuts and Jobs Act (TCJA) of 2017 changes as needed.
- Updated references and citations throughout the chapter.
- Updated discussion of taxation on the CPA exam.

THE BIG PICTURE

The Big Picture discussion in Chapter 2 introduces the introductory tax student to the idea that answers to tax questions will not always be found in the tax textbook and that research often needs to be undertaken to answer the question.

The discussion in Section 2-3 of the chapter takes the student through the answer to the research questions posed. Depending on the research services available, the instructor might ask the students to formulate keyword searches and then demonstrate what happens when those searches are undertaken in the research service. The instructor could ask the students to see if they could verify the correctness of the textbook conclusion or change one of the key facts and determine how the conclusion would change, if at all.

TAX SOURCES

Statutory Sources of the Tax Law

1. Statutory sources of law include the Constitution (Article I, Sections 7, 8, and 10), tax treaties, and the Internal Revenue Code.

2. Origin of the Internal Revenue Code.

a. Known as the Internal Revenue Code of 1939, the codification arranged all Federal tax provisions in a logical sequence and placed them in a separate part of the Federal statutes.

b. A further rearrangement took place in 1954 and resulted in the Internal Revenue Code of 1954, which continued in effect until 1986, when it was replaced by the Internal Revenue Code of 1986.

c. Although Congress did not recodify the law in the Tax Reform Act (TRA) of 1986, the magnitude of the changes made by TRA of 1986 did provide some rationale for renaming the Federal tax law the Internal Revenue Code of 1986.

3. The Legislative Process.

a. Exhibit 2.1 in the text illustrates the legislative process for enacting changes to the Internal Revenue Code of 1986.

b. Tax legislation normally originates in the House Ways and Means Committee of the House of Representatives because the U.S. Constitution mandates that revenue raising bills begin in the House. A tax bill might originate in the Senate when it is attached to other legislative proposals.

c. Tax legislation is referred from the Senate Finance Committee to the entire Senate. If the House and Senate tax bills disagree, the Joint Conference Committee resolves the differences. (See Exhibit 2.2 in the text.)

d. The Committee Reports explain the provisions of the proposed legislation and are a valuable source for ascertaining the intent of Congress. What Congress had in mind when it considered and enacted tax legislation is, of course, the key to interpreting the legislation by taxpayers, the IRS, and the courts.

4. Arrangement of the Internal Revenue Code. The Internal Revenue Code of 1986 is found in Title 26 of the U.S. Code. In working with the Code, it helps to understand the format. The key is usually the section number. For example, in citing Section 2(a), it is unnecessary to include Subtitle A, Chapter 1, Subchapter A, Part I. Mentioning Section 2(a) is sufficient.

5. Citing the Code. See the description in the text for form used to reference Code Sections.

Administrative Sources of the Tax Law (See Exhibit 2.3 in the text.)

6. Treasury Department Regulations. The Treasury Department under § 7805(a) has a duty to issue rules and regulations to explain and interpret the Code.

a. Regulations, which carry considerable authority as the official interpretation of tax law, may be issued in proposed, temporary, or final form.

(1) New Regulations and changes to existing Regulations are usually issued in proposed form before they are finalized. The interval between the proposal of a Regulation and its finalization permits taxpayers and other interested parties to comment on the propriety of the proposal. Proposed Regulations carry little weight.

(2) Final Regulations have the force and effect of law. Final Regulations are issued as Treasury Decisions (TDs) in the *Federal Register*. Regulations carry considerable authority as the official interpretation of tax statutes.

(3) Temporary Regulations are issues where immediate guidance is important.

b. Proposed, Temporary, and final Regulations are published in the *Federal Register*, in the *Internal Revenue Bulletin*, and by major tax services.

c. Regulations may also be classified as legislative, interpretive, or procedural.

7. Revenue Rulings and Revenue Procedures.

a. Revenue Rulings are official pronouncements of the National Office of the IRS and provide guidance to both IRS personnel and taxpayers in handling routine tax matters. They usually deal with more restricted problems than Regulations and do not carry the same legal force and effect as Regulations.

b. Revenue Procedures are issued in the same manner as Revenue Rulings, but they deal with the internal management practices and procedures of the IRS. Revenue Procedures do not carry the same legal force and effect as Regulations.

c. Both Revenue Rulings and Revenue Procedures serve an important function by providing guidance to IRS personnel and taxpayers in handling routine tax matters.

(1) They generally apply retroactively and are binding on the IRS until revoked or modified by subsequent rulings or procedures, Regulations, legislation, or court decisions.

(2) They are published weekly by the U.S. Government in the *Internal Revenue Bulletin* (I.R.B.).

(3) Revenue Rulings and other tax resources may be found at the IRS website: www.irs.gov.

8. Letter Rulings. A letter ruling is a statement issued by the National Office of the IRS in response to a taxpayer's request, which applies the tax law to a proposed transaction. Revenue rulings can result from a taxpayer request for a letter ruling.

9. Other Administrative Pronouncements.

   a. Treasury Decisions (TDs) are issued by the Treasury Department to announce new Regulations, amend or change existing Regulations, or announce the position of the Government on selected court decisions. TDs are published in the *Internal Revenue Bulletin*.

   b. The IRS also publishes other administrative communications in the *Internal Revenue Bulletin*, such as Announcements, Notices, IRs (News Releases), Internal Legal Memoranda (ILMs), Chief Counsel Notices (CC), and Prohibited Transaction Exemptions

   c. A determination letter is a statement issued by the Area Director in response to a taxpayer and provides guidance on the application of the tax law.

   d. A variety of internal memoranda that constitute the working law of the IRS also are released. These General Counsel Memoranda (GCMs), Technical Advice Memoranda (TAMs), Internal Legal Memoranda (ILMs), and Field Service Advice Memoranda (FSAs) are not officially published, and the IRS indicates that they may not be cited as precedents by taxpayers.

      (1) Technical Advice Memoranda (TAMs) are furnished by the National Office on a weekly basis. TAMs deal with completed (rather than proposed) transactions. TAMs are issued by the National Office of the IRS in response to questions raised by taxpayers or IRS field personnel during audits.

      (2) The Office of Chief Counsel prepares Field Service Advice Memoranda (FSAs) to help IRS employees. These are issued in response to requests for advice, guidance, and analysis on difficult or significant tax issues and are not binding on either the taxpayer to whom they pertain or the IRS.

      (3) Some FSAs are being replaced by another form of field guidance called Technical Expedited Advice Memoranda (TEAMs). The purpose of TEAMs is to expedite legal guidance to field agents as disputes are developing. FSAs are reverting to their original purpose of case-specific development of facts.

Judicial Sources of the Tax Law

10. Five Federal courts have jurisdiction over tax disputes between the IRS and taxpayers: the U.S. Tax Court, the U.S. District Court, the U.S. Court of Federal Claims, the U.S. Court of Appeals, and the U.S. Supreme Court. (See Figure 2-1 at the end of the Lecture Notes for this chapter for the location of Judicial Sources.)

11. The Judicial Process in General. After a taxpayer has exhausted some or all of the remedies available within the IRS, the dispute can be taken to the Federal courts. The

trial and appellate court system for Federal tax litigation is illustrated in Exhibit 2.4 in the text.

a. A trial court, also known as a court of original jurisdiction, initially hears the case. Appeals (either by the taxpayer or the IRS) are heard by the appropriate appellate court. A taxpayer has a choice of these four trial courts: a Federal District Court, the U.S. Court of Federal Claims, the U.S. Tax Court, or the Small Cases Division of the U.S. Tax Court.

b. The Small Cases Division of the U.S. Tax Court hears only cases involving amounts of $50,000 or less. No appeal available. The broken line between the U.S. Tax Court and the Small Cases Division in Exhibit 2.4 in the text indicates that there is no appeal from the Small Cases Division.

(1) This court hears cases involving disputed amounts of $50,000 or less.

(2) Informal proceedings.

(a) No necessity for the taxpayer to be represented by a lawyer or other tax adviser.

(b) Special trial judges, rather than Tax Court judges, preside over the proceedings.

(c) Decisions are not precedent for any other court and are not reviewable by any higher court.

c. American law, following English common law, is frequently "made" by judicial decisions. Under the doctrine of *stare decisis*, each decision has precedential value for future decisions with the same controlling set of facts.

d. At the trial court level, a taxpayer is normally the plaintiff (or petitioner), and the Government is the defendant (or respondent). If the taxpayer wins and the Government appeals, it becomes the petitioner (or appellant), and the taxpayer becomes the respondent.

12. Trial Courts. (See Concept Summary 2.1 in the text for a summary of various attributes of the Federal trial courts.) The differences among the various trial courts can be summarized as follows:

- Number of courts.
- Number of judges.
- Location.
- Jurisdiction of the Tax Court and District Courts.
- Jurisdiction of the Court of Federal Claims.
- Jury trial.
- Payment of deficiency.

- Appeals.
- Bankruptcy.
- Gray areas.

13. Appellate Courts. A trial court decision can be appealed to the appropriate Circuit Court of Appeals. The 11 geographic circuits, the circuit for the District of Columbia, and the Federal Circuit appear in Exhibit 2.5 in the text.

    a. Generally, a three-judge panel hears a Court of Appeals case, but occasionally the full court decides more controversial cases.

    b. If the Government loses at the trial court level (District Court, Tax Court, or Court of Federal Claims), it may decide not to appeal. However, the fact that the IRS does not appeal does not mean that the IRS agrees with the result.

    c. The Federal Circuit provides the taxpayer with an alternative forum. When a particular Circuit Court of Appeals has issued an adverse decision in a similar case, the taxpayer may prefer the Court of Federal Claims route, because any appeal is to the Federal Circuit.

14. The Appellate Process. The role of the appellate court is limited to a review of the trial record compiled by the trial court. The appellate process usually involves a determination of whether the trial court applied the proper law in arriving at its decision.

    a. Bound by findings of facts unless they are clearly erroneous.

    b. The appellate court may approve (affirm) or disapprove (reverse) the lower court's findings, or it may send the case back for further consideration (remand).

    c. Appellate Precedents and the Tax Court. District Courts, the Tax Court, and the Court of Federal Claims must abide by the precedents set by the Court of Appeals of jurisdiction.

    d. All courts must follow the decision of the U.S. Supreme Court.

    e. Since the *Golsen* decision [*Jack E. Golsen*, 54 T.C. 742 (1970)], the Tax Court decides a case as it believes the law should be applied only if the Court of Appeals has not passed on the issue.

    f. Appeal to the U.S. Supreme Court. The U.S. Supreme Court grants certiorari to resolve a conflict among the Courts of Appeals or where the tax issue is extremely important. The granting of a Writ of Certiorari indicates that at least four of the nine members of the Supreme Court believe that the issue is of sufficient importance to be heard by the full Court.

15. Judicial Citations. Judicial citations usually follow a standard pattern: case name, volume number, reporter series, page or paragraph number, court, and year of the decision (see Concept Summary 2.2 in the text).

a. Judicial Citations—The U.S. Tax Court. The U.S. Tax Court issues two types of decisions: Regular and Memorandum, based on the Chief Judge's determination. They differ in both substance and form.

(1) Memorandum decisions deal with cases that involve only the application of established principles of law.

(2) Regular decisions involve novel issues not previously resolved by the Tax Court.

(3) In actual practice, both Regular and Memorandum represent the position of the Tax Court and, as such, can be relied on.

(4) Regular Tax Court decisions are published by the U.S. Government Printing Office as the *Tax Court of the United States Reports*. Memorandum decisions are published by both CCH and RIA.

(5) If the IRS loses a decision, it may indicate whether it agrees or disagrees with the results reached by the court by publishing an acquiescence ("A" or "Acq.") or nonacquiescence ("NA" or "Nonacq."), respectively. The acquiescence or nonacquiescence is published in the *Internal Revenue Bulletin* as an *Action on Decision*.

b. Judicial Citations—The U.S. District Court, Court of Federal Claims, and Courts of Appeals. Decisions dealing with Federal tax matters are reported in both the CCH *U.S. Tax Cases* (USTC) and the RIA *American Federal Tax Reports* (AFTR) series. Federal District Court decisions, dealing with both tax and nontax issues, also are published by West in its *Federal Supplement Second Series*.

c. Judicial Citations—The U.S. Supreme Court. Decisions are published by CCH in the USTCs and by RIA in the AFTRs. The U.S. Government Printing Office also publishes these decisions in the *United States Supreme Court Reports* (U.S.), as does West in its *Supreme Court Reporter* (S.Ct.), and the Lawyer's Co-operative Publishing Company in its *United States Reports, Lawyer's Edition* (L.Ed.).

Other Sources of the Tax Law

16. Tax Treaties. Tax legislation enacted in 1988 provided that neither a tax law nor a tax treaty takes general precedence. If there is a conflict between the Code and a treaty, the most recent item takes precedence.

17. Tax Periodicals. Can shorten the research time needed to resolve a tax issue.

WORKING WITH THE TAX LAW—TAX RESEARCH TOOLS

Commercial Tax Services

18. In the past, commercial tax services could be classified as annotated or topical. However, as tax research has become electronic, this classification system is no longer appropriate. Some of the available commercial tax services include:

    a. *Standard Federal Tax Reporter*, Commerce Clearing House.

    b. *CCH IntelliConnect*, Commerce Clearing House. The online version of the *Standard Federal Tax Reporter* (along with other CCH materials).

    c. *United States Tax Reporter*, Research Institute of America's (RIA), Thomson Reuters.

    d. Thomson Reuters *Checkpoint*, Research Institute of America. The online versions of RIA's *Federal Tax Coordinator 2d* and *United States Tax Reporter.*

    e. *Practical Tax Expert*, CCH/Wolters Kluwer.

    f. *Tax Management Portfolios*, Bloomberg BNA.

    g. *Mertens Law of Federal Income Taxation*, Thomson Reuters.

    h. Thomson Reuters *Westlaw* and *WestlawNext*—compilations include access to *Tax Management Portfolios*, *Federal Tax Coordinator 2d*, and *Mertens*.

    i. LexisNexis *TaxCenter*. A compilation of primary sources and various materials taken from CCH, Matthew Bender, Kleinrock, and Bloomberg BNA.

19. Assessing tax services. In terms of assessing the major tax services, the following points are relevant:

    a. Except for arrangement of the subject matter, there is not much difference between CCH's *Standard Federal Tax Reporter* and RIA's *United States Tax Reporter*.

    b. RIA's editorial content is generally more detailed than CCH's editorial content. The RIA editorial materials also contain more detailed tax-planning discussions. However, many practitioners feel that rule coverage and case law background are more extensive in CCH.

c. Mertens is an excellent source if the emphasis is on background material for in-depth research. Mertens is, however, difficult reading due to its legalistic style. Also, updating is less frequent than most other services and not as accessible.

d. BNA's *Tax Management Portfolios* (TMPs) comprise a series of monographs on various subjects. As the treatment of a subject usually is exhaustive, a portfolio can serve as a convenient means of familiarizing the reader with the material. Note that portfolios are generally updated on a three-year cycle.

e. In summary, the day-to-day, all-purpose services are CCH and RIA. Mertens and the TMPs are useful for more extensive research and background.

Using Electronic (Online) Tax Services

20. A competent tax professional must become familiar and proficient with electronic research services and be able to use them to complete research projects efficiently.

21. Following certain general procedures can simplify the research process. The following suggestions may be helpful:

    a. Choose keywords for the search carefully.

    b. Take advantage of connectors.

    c. Be selective in choosing a database.

    d. Use a table of contents, index, or citation approach.

Noncommercial Electronic (Online) Tax Services

22. The internet provides a wealth of tax information in several popular forms, sometimes at no cost to the researcher.

23. A tax professional can access a significant amount of information that can assist in the research process.

    a. Websites are provided by accounting and consulting firms, publishers, tax academics, libraries, and governmental bodies as a means of making information widely available. One of the best sites available to the tax professional is the Internal Revenue Service's home page, illustrated in Exhibit 2.6 of the text.

    b. Exhibit 2.7 in the text lists some of the websites that may be most useful to tax researchers. The directory at taxsites.com provides links to accounting and tax sources (including international, state, and payroll tax sources).

c. Blogs and RSS sites provide a means by which information related to the tax law can be exchanged among taxpayers, tax professionals, and others who subscribe to the group's services.

WORKING WITH THE TAX LAW—TAX RESEARCH

24. Tax research is the process of finding a professional conclusion to a tax problem. The problem might originate either from completed or proposed transactions.

25. Tax research involves the following procedures (illustrated in Exhibit 2.8 in the text):

    a. Identifying and refining the problem.

    b. Locating the appropriate tax law sources.

    c. Assessing the validity of the tax law sources.

    d. Arriving at the solution or at alternative solutions with due consideration given to nontax factors.

    e. Effectively communicating the solution to the taxpayer or the taxpayer's representative.

    f. Updating the solution in light of new developments.

Identifying the Problem

26. Problem identification must start with a compilation of the relevant facts involved. In other words, all the facts that may have a bearing on the problem must be gathered.

Refining the Problem

27. Use new facts to refine the tax problem.

Locating the Appropriate Tax Law Sources

28. Once the problem is clearly defined, we index the volume of a hard copy tax service or a keyword search on an online tax service.

Assessing the Validity of the Tax Law Sources

29. Once a source has been located, the next step is to assess it in light of the problem at hand. Proper assessment involves careful interpretation of the tax law with consideration given to its relevance and validity.

30. Interpreting the Internal Revenue Code. This is the greatest challenge for the IRS. The language of the Code is difficult to comprehend fully.

31. Assessing the Validity of a Treasury Regulation.

    a. Give the Code equal weight when dealing with taxpayers and their representatives.

    b. Proposed regulations are not binding.

    c. The burden of proof is on the taxpayer.

    d. If the taxpayer loses the challenge, then a 20% negligence penalty may be imposed.

    e. Final regulations can be classified as procedural, interpretive, or legislative. Procedural Regulations are housekeeping-type instructions indicating information that taxpayers should provide the IRS.

    f. Interpretive regulations are hard and solid and almost impossible to overturn.

    g. In some Code sections, Congress has given the Treasury Secretary the authority to prescribe Regulations to carry out the details of administration. Regulations issued under this type of authority possess the force and effect of law and are often called legislative Regulations.

    h. Courts tend to apply the legislative reenactment doctrine.

32. Assessing the Validity of Other Administrative Sources of the Tax Law. In any dispute with the IRS on the interpretation of tax law.

33. Assessing the Validity of Judicial Sources of the Tax Law. How much reliance can be placed on a particular decision depends on the following variables:

    a. The level of court. The higher the level of the court that issued a decision, the greater the weight accorded to that decision.

    b. Residence of the taxpayer. More reliance is placed on decisions of courts that have jurisdiction in the area where the taxpayer's legal residence is located.

    c. Regular or Memorandum decision. A Tax Court Regulator decision carries more weight than a memorandum decision, because the Tax Court does not consider memorandum decisions to be binding.

    d. Supreme Court certiorari. A Circuit Court decision where certiorari has been requested and denied by the U.S. Supreme Court carries more weight than a Circuit Court decision that was not appealed.

e. Other courts' support. A decision that is supported by cases from other courts carries more weight than a decision that is not supported by other cases.

f. Status on appeal. The weight of a decision also can be affected by its status on appeal.

g. In connection with the last three variables, the use of a citator is invaluable to tax research. A citator provides the history of a case, including the authority relied on in reaching the result.

34. Assessing the Validity of Other Sources. (See Table 2-1 at the end of the Lecture Notes for this chapter for a list of primary and secondary sources.)

a. Primary sources of tax law include the Constitution, legislative history materials, statutes, treaties, Treasury Regulations, IRS pronouncements, and judicial decisions.

b. Reference to secondary sources such as legal periodicals, treatises, legal opinions, IRS publications, and other materials can be useful. In general, secondary sources are not authority.

c. For purposes of the accuracy-related penalty, the IRS expanded the list of substantial authority for purposes of the accuracy-related penalty in § 6662 to include a number of secondary materials.

d. A letter ruling or determination letter is substantial authority only for the taxpayer to whom it is issued, except for the accuracy-related penalty.

e. Once major tax legislation is completed, the staff of the Joint Committee on Taxation (in consultation with the staffs of the House Ways and Means and Senate Finance Committees) often prepares a General Explanation of the Act, commonly known as the Bluebook.

FINANCIAL DISCLOSURE INSIGHTS

Where Does GAAP Come From? In reconciling the tax and financial accounting reporting of a transaction, the tax professional needs to know the hierarchy of authority of accounting principles—in particular, the level of importance to assign to a specific GAAP document. Discuss the diagram presented in the text which shows the sources of GAAP, arranged in a general order of authority from highest to lowest.

Arriving at the Solution or at Alternative Solutions

35. Discuss possible solutions to The Big Picture questions.

Communicating Tax Research

36. A good tax research communication should tell the audience what was researched, the results of the research, and the justification for the recommendation made. It should contain:
    - A clear statement of the issue.
    - A short review of the facts that raise the issue.
    - A review of the pertinent tax law source.
    - Any assumptions made in arriving at the solution.
    - The solution recommended and the logic or reasoning supporting it.
    - The references consulted in the research process.

37. Exhibits 2.9 and 2.10 in the text, present the tax file memos (internal to the firm) and the client letter associated with the facts of The Big Picture.

WORKING WITH THE TAX LAW—TAX PLANNING

38. Tax research and tax planning are inseparable.

    a. The primary purpose of effective tax planning is to reduce the taxpayer's total tax bill.

    b. The secondary objective of effective tax planning is to reduce or defer the tax in the current tax year.

Nontax Considerations

39. Tax considerations may impair the exercise of sound business judgment by the taxpayer. The goal should be a balance that recognizes the significance of taxes, but not beyond the point where planning detracts from the exercise of good business judgment.

Components of Tax Planning

40. The popular perception of tax planning often is restricted to the adage "defer income and accelerate deductions." Although this timing approach does hold true and is important, meaningful tax planning involves considerably more.

41. The key components of tax planning include the following:

    a. Avoid the recognition of income.

    b. Defer the recognition of income.

    c. Convert the classification of income.

    d. Choose the business entity with the desired tax attributes.

e. Preserve formalities by generating and maintaining supporting documentation.

f. Act in a manner consistent with the intended objective.

Tax Avoidance and Tax Evasion

42. Avoidance versus evasion. There is a fine line between legal tax planning and illegal tax planning—tax avoidance versus tax evasion. However, the consequences of the two are as vast as the difference between a lightning bug and lightning.

    a. Tax avoidance is merely tax minimization through legal techniques. In this sense, tax avoidance becomes the proper objective of all tax planning.

    b. Evasion, while also aimed at the elimination or reduction of taxes, connotes the use of subterfuge and fraud as a means to an end.

Follow-Up Procedures

43. Because tax planning usually involves a proposed transaction, being aware of if or when the law changes is critical to the tax planning process. A change in the tax law could alter the original conclusion. Additional research may be necessary to test the solution in light of current developments. (Refer to the broken lines at the right in Exhibit 2.8 in the text.)

Tax Planning

44. Point out that throughout this text, each chapter concludes with observations on Tax Planning.

TAXATION ON THE CPA EXAMINATION

45. The CPA exam was revised in 2017. The CPA exam continues to test in the familiar four sections—Auditing and Attestation (AUD), Business Environment and Concepts (BEC), Financial Accounting and Reporting (FAR), and Regulation (REG).

46. The exam places less emphasis on remembering and understanding skills, enabling higher-level analysis and evaluation skills to be tested:

    a. The number of task-based simulations, a highly effective way to assess higher-order skills, increased.

    b. Total testing time is 16 hours.

    c. Multiple-choice questions and task-based simulations each contribute about 50% toward the candidate's score in the AUD, FAR, and REG sections. In the BEC section, multiple-choice questions contribute about 50% of the scoring, with 35% coming from task-based simulations and 15% from written communication.

d. The revised CPA exam places less emphasis on multiple-choice questions, with about 50% of the total points.

e. The revised CPA exam tests remembering and understanding, application, analysis, and evaluation. The previous CPA exam only tested for the first two of these items.

Preparation Blueprints

47. To prepare for the revised CPA exam, candidates are able to use new AICPA-developed blueprints that replaced the Content Specification Outline (CSO) and Skill Specification Outline (SSO).

48. The blueprints provide candidates with more detail about what to expect on the exam and contain about 600 representative tasks.

49. The blueprints provide candidates with sample tasks that align with both the content and skill level at which the content will be tested.

Regulation Section

50. Taxation continues to be tested within the REG section of the CPA exam. Testing within REG is administered in five blocks called testlets, which feature multiple-choice questions (MCQs) and task-based simulations (TBSs).

51. There are five content areas in the REG section of the CPA exam:
    - Area 1: Ethics, professional responsibilities, and Federal tax procedures (weight: 10% to 20%).
    - Area 2: Business law (weight: 10% to 20%).
    - Area 3: Federal taxation of property transactions (weight: 12% to 22%).
    - Area 4: Federal taxation of individuals (weight: 15% to 25%).
    - Area 5: Federal taxation of entities (weight: 28% to 38%).

52. Candidates can learn more about the CPA examination at www.cpa-exam.org. This online tutorial site's topics include:
    - Common tools.
    - Navigation.
    - Form completion.
    - Numeric entry.
    - Research questions.
    - Authoritative literature search.
    - Written communication.

Table 2-1
Primary and Secondary Tax Law Sources

	Primary	Secondary
Sixteenth Amendment to Constitution	X	
Tax Treaty	X	
Internal Revenue Code Section	X	
U.S. Supreme Court Decision	X	
U.S. Circuit Court of Appeals Decision	X	
Tax Court Memorandum Decision	X	
Tax Court Regular Decision	X	
U.S. District Court Decision	X	
U.S. Court of Federal Claims Decision	X	
Small Cases Division of U.S. Tax Court	X**	
Final Regulation	X	
Temporary Regulation	X*	
Proposed Regulation	X***	
Revenue Ruling	X	
Revenue Procedure	X	
Senate Finance Committee Report	X	
Bluebook		X
Letter Ruling		X
Technical Advice Memorandum		X
Actions on Decisions		X
Determination Letter		X
Harvard Law Review article		X
Field Service Advice		X
General Counsel Memorandum		X

* Can be outstanding for three years at most.

The categorization of a tax law source as a primary or a secondary source is not black and white. All of the sources categorized as primary in the above table are so categorized because all can be relied on to defend against the application of penalties by the IRS. However, note the following:

** The Tax Court indicates that Small Cases Division opinions should not be used or cited as precedent. As such, these decisions could be categorized as secondary sources.

*** Proposed regulations are not binding. That is, a taxpayer is not required to follow the guidance in the proposed regulation unless (or until) the regulation becomes final. This could lead to the categorization of a proposed regulation as a secondary source.

Figure 2-1
Location of Judicial Sources

	USTC Series	AFTR Series	F.Supp. Series	F.3d Series	Cls.Ct. Series	S.Ct. Series[a]
U.S. District Courts (tax cases)	Yes	Yes	Yes	No	No	No
U.S. Tax Court[b]	No[c]	No[c]	No	No	No	No
U.S. Court of Federal Claims[d] (tax cases)	Yes	Yes	No[e]	Yes[e]	Yes[e]	No
U.S. Courts of Appeal (tax cases)	Yes	Yes	No	Yes	No	No
U.S. Supreme Ct. (tax cases)	Yes	Yes	No	No	No	Yes
U.S. District Courts[f] (all cases)	No	No	Yes	No	No	No
U.S. Courts of Appeal (all cases)	No	No	No	Yes	No	No
U.S. Supreme Court (all cases)	No	No	No	No	No	Yes

<u>Notes for Figure 2-1:</u>

a Answers also apply to the *United States Supreme Court Reports* (abbreviated U.S.) and to the *United States Reports*, *Lawyers Edition* (abbreviated L.Ed.).

b Regular (not memorandum) decisions are published by the U.S. Government Printing Office (GPO) in *Tax Court of the United States Reports*.

c Both CCH and RIA have separate reporters for Regular, Memorandum, and Small Cases Division decisions of the U.S. Tax Court.

d All decisions (both tax and nontax) of the U.S. Court of Federal Claims are published by the U.S. GPO in the *Claims Court Reporter Series*. From 1960 to October 1, 1982, Court of Claims decisions were published in the *Court of Claims Reporter Series*.

e From 1932 to 1960, the Court of Claims decisions were published in the *F.Supp. Series*. Beginning October 1982, the Claims Court decisions are published in the *Claims Court Reporter*. Beginning on October 30, 1992, the Claims Court underwent a further name change. The new designation, U.S. Court of Federal Claims, begins with Volume 27 of the former *Cl.Ct.* (West citation) now abbreviated as *Fed.Cl*.

f "All cases" has reference to nontax as well as tax decisions. Thus, it would include such varied issues as interstate transportation of stolen goods, civil rights violations, and anti-trust suits.

ETHICS AND EQUITY FEATURES

Solutions to Ethics & Equity features are located in the Solutions Manual.

RESEARCH PROBLEMS

Solutions to end-of-chapter Research Problems are located in the Solutions Manual.

IN-CLASS EXERCISES

Q1. The shareholders of Red Corporation and Green Corporation want assurance that the consolidation of both into a single corporation, Blue Corporation, will be a nontaxable reorganization. Should a letter ruling or a determination letter be requested from the IRS? Explain when each is used.

Solution:
The proper approach is to request that the National Office of the IRS issue a letter ruling concerning the income tax effect of the proposed transaction. Letter rulings are issued for a fee upon a taxpayer's request and describe how the IRS will treat a proposed transaction for tax purposes. They apply only to the taxpayer who asks for and obtains the ruling. Letter rulings can be useful to taxpayers who want to be certain of how a transaction will be taxed before proceeding. Letter rulings also allow taxpayers to avoid unexpected tax costs and may be the most effective way to carry out tax planning. However, the IRS limits the issuance of individual rulings to restricted, preannounced areas of taxation.

Determination letters are issued at the request of taxpayers and provide guidance on the application of the tax law. They differ from letter rulings in that the issuing source is an IRS Area Director (rather than the National Office of the IRS). Also, determination letters usually involve completed (as opposed to proposed) transactions.

Q2. During the year, Amy earned $2,000 working as an independent consultant. She has decided not to declare the income on her return since no 1099s were issued to her. Is this considered tax avoidance or tax evasion?

Solution:
A fine line exists between legal tax planning and illegal tax planning—tax avoidance versus tax evasion. Tax avoidance is merely tax minimization through legal techniques, which is the proper objective of all tax planning. Tax evasion, while also aimed at the elimination or reduction of taxes, connotes the use of subterfuge and fraud as a means to an end. Since Sue has chosen not to report the income on her return, she has committed tax evasion.

SOUTHERN ILLINOIS UNIVERSITY

,
618-457-6731

January 21, 2019

Pet Kingdom, Inc.
1010 Northwest Parkway
Dallas, TX 75225
US

Dear Client:

Your 2018 Federal Corporation Income Tax Return will be electronically filed with the Internal Revenue Service upon receipt of a signed Form 8879C - IRS e-file Signature Authorization. No tax is payable with the filing of this return. You will receive a refund of $2,266.

All payments due must be electronically deposited through the Electronic Federal Tax Payment System (EFTPS). For EFTPS deposits to be made on time, the transaction must be initiated at least one business day before the date the deposit is due.

Your 2019 Texas Franchise Tax Return will be electronically filed with the State of Texas. There is a balance payable of $18,509. Mail the payment with Form 05-170 Texas Franchise Tax Payment Form on or before May 15, 2019. Write the Texas taxpayer identification number and the report year on the check or money order.

Make check payable to State Comptroller and mail to:

TEXAS COMPTROLLER OF PUBLIC ACCOUNTS
P.O. BOX 149348
AUSTIN, TX 78714-9348

Your estimated tax schedule for 2019 is listed below:

Due Date	Federal
4/15/19	$ 55,434
6/17/19	55,434
9/16/19	55,434
12/16/19	55,434

	$ 221,736

Please be sure to call if you have any questions.

Sincerely,

Raymond Wacker

Pet Kingdom, Inc. 11-1111112

INCOME

Gross receipts less returns/allowance	5,550,000
Cost of goods sold	2,300,000
Gross Profit	3,250,000
Dividends	43,750
Interest	20,000
Total income	3,313,750

DEDUCTIONS

Compensation of officers	525,000
Salaries/wages less employment credits	725,000
Repairs and maintenance	140,000
Rents	109,000
Taxes and licenses	238,000
Interest	207,000
Contributions	38,000
Depreciation	136,000
Advertising	58,000
Employee benefit programs	60,000
Total deductions	2,236,000

TAXABLE INCOME

Taxable income (line 28)	1,077,750
Less special deductions	21,875
Taxable income	1,055,875

TAX COMPUTATION

Income tax	221,734
Total tax	221,734

[DO NOT FILE]

PAYMENTS AND CREDITS

Estimated tax payments	224,000
Total payments and credits	224,000

REFUND OR AMOUNT DUE

Overpayment	2,266
Tax due	0
Refund	2,266

SCHEDULE L

Beginning Assets	13,714,000
Beginning Liabilities & Equity	13,714,000
Ending Assets	13,802,727
Ending Liabilities & Equity	13,802,727

TAX RATES

Marginal tax rate	21.0%
Effective tax rate	21.0%

Pet Kingdom, Inc. **11-1111112**

ENDING ASSETS

Cash		1,039,461
Accounts receivable	2,147,000	
Less: Allowance for bad debts	(0)	2,147,000
Inventories		3,030,000
Tax exempt securities		375,000
Other current assets		1,527,266
Buildings and other assets	5,455,000	
Less: Accumulated depreciation	(712,000)	4,743,000
Other assets		941,000
Total Assets		13,802,727

ENDING LIABILITIES & EQUITY

Accounts payable		1,840,711
Short term notes payable		4,575,000
Other current liabilities		155,000
Common stock	2,500,000	2,500,000
Unappropriated retained earnings		4,732,016
Total Liabilities and Equity		13,802,727

Pet Kingdom, Inc.

REVENUE

Gross receipts or sales	5,550,000
Dividend	43,750
Interest	20,000
Total gross revenue	5,613,750
Deductions from gross revenue	21,875
Total revenue	5,591,875

COST OF GOODS SOLD

Cost of goods sold	2,580,000
Total cost of goods sold	2,580,000

COMPENSATION

Wages and cash compensation	1,250,000
Employee benefits	60,000
Total compensation	1,310,000

MARGIN

Percent margin	3,914,312
COGS margin	3,011,875
Compensation margin	4,281,875
Less than 1 million margin	4,591,875
Margin	3,011,875

APPORTIONMENT FACTOR

Gross receipts in Texas	5,591,875
Gross receipts everywhere	5,591,875
Apportionment factor	1.00000

TAXABLE MARGIN

Apportioned margin	3,011,875
Taxable margin	3,011,875
Apportioned revenue (EZ computation)	5,591,875

TAX DUE

Tax rate	0.3310%

TAX ADJUSTMENTS

Tax due before discount	18,509

AMOUNT DUE AND PAYABLE

Total amount due and payable	18,509

TAX RATES

Marginal tax rate	0.6%
Effective tax rate	0.3%

Charitable Contribution Deduction

Total		$ 38,000.
	Total	$ 38,000.

Computation of Net Income (Loss) Per Books
Form 1120, Schedule M-1, Line 1

Income (loss) per return (Page 1, line 28)	1,077,750.
Increases:	
Deductions on return not recorded on books (Sch. M-1, line 8)	30,000.
Income recorded on books not included on return (Sch. M-1, line 7)	15,000.
Decreases:	
Expenses recorded on books not deducted on return (Sch. M-1, line 5)	-49,000.
Income subject to tax not recorded on books (Sch. M-1, line 4)	0.
Excess of capital losses over capital gains (Sch. M-1, line 3)	0.
Federal income tax per books (Sch. M-1, line 2)	-221,734.
Computed net income (loss) per books (Sch. M-1, line 1)	852,016.
Less: Net income (loss) per books (memo only entry)	1,073,750.
Unreconciled difference	-221,734.

Pet Kingdom, Inc. 11-1111112

Texas Franchise Tax
Deductions From Gross Revenue

Schedule C dividends received	21,875.
Total deductions from gross revenue	21,875.

Texas Franchise Tax
Cost of Goods Sold

Purchases	2,580,000.
Total cost of goods sold	2,580,000.

Texas Franchise Tax
Wages and Cash Compensation

Salaries and wages, other than officers	725,000.
Janet Morton (Limited to $370,000)	262,500.
Kim Wong (Limited to $370,000)	262,500.
Total wages and cash compensation from reporting entity	1,250,000.
Total wages and cash compensation	1,250,000.

Texas Franchise Tax
Employee Benefits

Employee benefit programs	60,000.
Total employee benefits from reporting entity	60,000.
Total employee benefits	60,000.

Form **1120-W** (WORKSHEET)

Department of the Treasury Internal Revenue Service

Estimated Tax for Corporations

For calendar year 2019, or tax year beginning ____________, 2019, and ending ____________, ________

▸ Go to *www.irs.gov/Form1120W* for instructions and the latest information.

▸ Keep for the corporation's records — Do *not* send to the Internal Revenue Service.

OMB No. 1545-0123

2019

Name: Pet Kingdom, Inc.

Employer identification no.: 11-1111112

Estimated Tax Computation

		Line	Amount
1	Taxable income expected for the tax year	1	1,055,875.
2	Multiply line 1 by 21% (0.21)	2	221,734.
3	Tax credits. See instructions	3	
4	Subtract line 3 from line 2	4	221,734.
5	Other taxes. See instructions	5	
6	**Total tax.** Add lines 4 and 5	6	221,734.
7	Credit for federal tax paid on fuels and other refundable credits. See instructions	7	
8	Subtract line 7 from line 6. **Note:** If the result is less than $500, the corporation is not required to make estimated tax payments	8	221,734.
9 a	Enter the tax shown on the corporation's 2018 tax return. See instructions. **Caution:** If the tax is zero or the tax year was for less than 12 months, skip this line and enter the amount from line 8 on line 9b	9a	221,734.
b	Enter the **smaller** of line 8 or line 9a. If the corporation is required to skip line 9a, enter the amount from line 8 (adjusted due to rounding)	9b	221,736.

			(a)	(b)	(c)	(d)
10	**Installment due dates.** See instructions ▸	10	4/15/19	6/17/19	9/16/19	12/16/19
11	**Required installments.** Enter 25% of line 9b in columns **(a)** through **(d)**. If the corporation uses the annualized income installment method or adjusted seasonal installment method or is a 'large corporation,' see the instructions for the amount to enter	11	55,434.	55,434.	55,434.	55,434.

[DO NOT FILE]

Form **8879-C**

Department of the Treasury
Internal Revenue Service

IRS *e-file* Signature Authorization for Form 1120

For calendar year **2018,** or tax year beginning ________ , **2018,** ending ________ , ______

► **Do not send to the IRS. Keep for your records.**
► **Go to *www.irs.gov/Form8879C* for the latest information.**

OMB No. 1545-0123

2018

Name of corporation	**Employer identification number**
Pet Kingdom, Inc.	11-1111112

Part I Tax Return Information (Whole dollars only)

1	Total income (Form 1120, line 11)	**1**	3,313,750.
2	Taxable income (Form 1120, line 30)	**2**	1,055,875.
3	Total tax (Form 1120, line 31)	**3**	221,734.
4	Amount owed (Form 1120, line 35)	**4**	
5	Overpayment (Form 1120, line 36)	**5**	2,266.

Part II Declaration and Signature Authorization of Officer. Be sure to get a copy of the corporation's return.

Under penalties of perjury, I declare that I am an officer of the above corporation and that I have examined a copy of the corporation's 2018 electronic income tax return and accompanying schedules and statements and to the best of my knowledge and belief, it is true, correct, and complete. I further declare that the amounts in Part I above are the amounts shown on the copy of the corporation's electronic income tax return. I consent to allow my electronic return originator (ERO), transmitter, or intermediate service provider to send the corporation's return to the IRS and to receive from the IRS **(a)** an acknowledgement of receipt or reason for rejection of the transmission, **(b)** the reason for any delay in processing the return or refund, and **(c)** the date of any refund. If applicable, I authorize the U.S. Treasury and its designated Financial Agent to initiate an electronic funds withdrawal (direct debit) entry to the financial institution account indicated in the tax preparation software for payment of the corporation's federal taxes owed on this return, and the financial institution to debit the entry to this account. To revoke a payment, I must contact the U.S. Treasury Financial Agent at **1-888-353-4537** no later than 2 business days prior to the payment (settlement) date. I also authorize the financial institutions involved in the processing of the electronic payment of taxes to receive confidential information necessary to answer inquiries and resolve issues related to the payment. I have selected a personal identification number (PIN) as my signature for the corporation's electronic income tax return and, if applicable, the corporation's consent to electronic funds withdrawal.

Officer's PIN: check one box only

[X] I authorize ______________________ to enter my PIN ____________ as my signature
ERO firm name **do not enter all zeros**

on the corporation's 2018 electronically filed income tax return.

[ ] As an officer of the corporation, I will enter my PIN as my signature on the corporation's 2018 electronically filed income tax return.

Officer's signature ► ______________________ Date ► ____________ Title ► ____________

[DO NOT FILE]

Part III Certification and Authentication

ERO's EFIN/PIN. Enter your six-digit EFIN followed by your five-digit self-selected PIN. ____________
do not enter all zeros

I certify that the above numeric entry is my PIN, which is my signature on the 2018 electronically filed income tax return for the corporation indicated above. I confirm that I am submitting this return in accordance with the requirements of **Pub. 3112,** IRS *e-file* Application and Participation, and **Pub. 4163,** Modernized e-File (MeF) Information for Authorized IRS *e-file* Providers for Business Returns.

ERO's signature ► ______________________ Date ► ____________

ERO Must Retain This Form — See Instructions
Do Not Submit This Form to the IRS Unless Requested To Do So

Form **1120**

Department of the Treasury
Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2018 or tax year beginning __________ , 2018, ending __________ , ________

► **Go to *www.irs.gov/Form1120* for instructions and the latest information.**

OMB No. 1545-0123

2018

A Check if:
1 a Consolidated return (attach Form 851) . . ☐
b Life/nonlife consolidated return . . . . . . ☐
2 Personal holding co. (attach Sch. PH) . . . ☐
3 Personal service corp. (see instrs) . . ☐
4 Schedule M-3 attached X

TYPE OR PRINT

Pet Kingdom, Inc.
1010 Northwest Parkway
Dallas, TX 75225 US

B Employer identification number: 11-1111112

C Date incorporated: 11/01/2008

D Total assets (see instructions): $ 13,802,727.

E Check if: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change

INCOME

1 a	Gross receipts or sales	1 a	5,750,000.		
b	Returns and allowances	1 b	200,000.		
c	Balance. Subtract line 1b from line 1a			1 c	5,550,000.
2	Cost of goods sold (attach Form 1125-A)			2	2,300,000.
3	Gross profit. Subtract line 2 from line 1c			3	3,250,000.
4	Dividends and inclusions (Schedule C, line 23, column (a))			4	43,750.
5	Interest			5	20,000.
6	Gross rents			6	
7	Gross royalties			7	
8	Capital gain net income (attach Schedule D (Form 1120))			8	
9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)			9	
10	Other income (see instructions — attach statement)			10	
11	**Total income.** Add lines 3 through 10 ►			11	3,313,750.

DEDUCTIONS (SEE INSTRUCTIONS FOR LIMITATIONS ON DEDUCTIONS)

12	Compensation of officers (see instructions — attach Form 1125-E) ►			12	525,000.
13	Salaries and wages (less employment credits)			13	725,000.
14	Repairs and maintenance			14	140,000.
15	Bad debts			15	
16	Rents			16	109,000.
17	Taxes and licenses			17	238,000.
18	Interest (see instructions)			18	207,000.
19	Charitable contributions			19	38,000.
20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)			20	136,000.
21	Depletion			21	
22	Advertising			22	58,000.
23	Pension, profit-sharing, etc., plans			23	
24	Employee benefit programs			24	60,000.
25	Reserved for future use			25	
26	Other deductions (attach statement)			26	
27	**Total deductions.** Add lines 12 through 26 ►			27	2,236,000.
28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11			28	1,077,750.
29 a	Net operating loss deduction (see instructions)	29 a			
b	Special deductions (Schedule C, line 24, column (c))	29 b	21,875.		
c	Add lines 29a and 29b			29 c	21,875.

TAX, REFUNDABLE CREDITS, AND PMTS

30	**Taxable income.** Subtract line 29c from line 28. See instructions		30	1,055,875.
31	Total tax (Schedule J, Part I, line 11)		31	221,734.
32	2018 net 965 tax liability paid (Schedule J, Part II, line 12)		32	
33	Total payments, credits, and section 965 net tax liability (Schedule J, Part III, line 23)		33	224,000.
34	Estimated tax penalty. See instructions. Check if Form 2220 is attached ► ☐		34	
35	**Amount owed.** If line 33 is smaller than the total of lines 31, 32, and 34, enter amount owed		35	
36	**Overpayment.** If line 33 is larger than the total of lines 31, 32, and 34, enter amount overpaid		36	2,266.
37	Enter amount from line 36 you want: **Credited to 2019 estimated tax** ►	**Refunded** ►	37	2,266.

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.

► Signature of officer | Date | ► Title

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
	Self-Prepared			

Firm's name ►
Firm's EIN ►
Firm's address ►
Phone no.

Schedule C **Dividends, Inclusions, and Special Deductions** (see instructions)	**(a)** Dividends and inclusions	**(b)** Percentage	**(c)** Special deductions **(a)** x **(b)**
1 Dividends from less-than-20%-owned domestic corporations (other than debt-financed stock)	43,750.	50	21,875.
2 Dividends from 20%-or-more-owned domestic corporations (other than debt-financed stock)		65	
3 Dividends on certain debt-financed stock of domestic and foreign corporations		see instructions	
4 Dividends on certain preferred stock of less-than-20%-owned public utilities		23.3	
5 Dividends on certain preferred stock of 20%-or-more-owned public utilities		26.7	
6 Dividends from less-than-20%-owned foreign corporations and certain FSCs		50	
7 Dividends from 20%-or-more-owned foreign corporations and certain FSCs		65	
8 Dividends from wholly owned foreign subsidiaries		100	
9 **Subtotal.** Add lines 1 through 8. See instructions for limitations	43,750.	see instructions	21,875.
10 Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958		100	
11 Dividends from affiliated group members		100	
12 Dividends from certain FSCs		100	
13 Foreign-source portion of dividends received from a specified 10%-owned foreign corporation (excluding hybrid dividends) (see instructions)		100	
14 Dividends from foreign corporations not included on line 3, 6, 7, 8, 11, 12, or 13 (including any hybrid dividends)			
15 Section 965(a) inclusion		see instructions	
16a Subpart F inclusions derived from the sale by a controlled foreign corporation (CFC) of the stock of a lower-tier foreign corporation treated as a dividend (attach Form(s) 5471) (see instructions)		100	
b Subpart F inclusions derived from hybrid dividends of tiered corporations (attach Form(s) 5471) (see instructions)			
c Other inclusions from CFCs under subpart F not included on line 15, 16a, 16b, or 17 (attach Form(s) 5471) (see instructions)			
17 Global Intangible Low-Taxed Income (GILTI) (attach Form(s) 5471 and Form 8992)			
18 Gross-up for foreign taxes deemed paid			
19 IC-DISC and former DISC dividends not included on line 1, 2, or 3			
20 Other dividends			
21 Deduction for dividends paid on certain preferred stock of public utilities			
22 Section 250 deduction (attach Form 8993)			
23 **Total dividends and inclusions.** Add lines 9 through 20. Enter here and on page 1, line 4	43,750.		
24 **Total special deductions.** Add lines 9 through 22, column (c). Enter here and on page 1, line 29b			21,875.

Schedule J Tax Computation and Payment (see instructions)

Part I — Tax Computation

1	Check if the corporation is a member of a controlled group (attach Schedule O (Form 1120)). See instructions ► ☐		
2	Income tax. See instructions	2	221,734.
3	Base erosion minimum tax (attach Form 8991)	3	
4	Add lines 2 and 3	4	221,734.
5a	Foreign tax credit (attach Form 1118) — 5a		
b	Credit from Form 8834 (see instructions) — 5b		
c	General business credit (attach Form 3800) — 5c		
d	Credit for prior year minimum tax (attach Form 8827) — 5d		
e	Bond credits from Form 8912 — 5e		
6	**Total credits.** Add lines 5a through 5e	6	
7	Subtract line 6 from line 4	7	221,734.
8	Personal holding company tax (attach Schedule PH (Form 1120))	8	
9a	Recapture of investment credit (attach Form 4255) — 9a		
b	Recapture of low-income housing credit (attach Form 8611) — 9b		
c	Interest due under the look-back method — completed long-term contracts (attach Form 8697) — 9c		
d	Interest due under the look-back method — income forecast method (attach Form 8866) — 9d		
e	Alternative tax on qualifying shipping activities (attach Form 8902) — 9e		
f	Other (see instructions — attach statement) — 9f		
10	**Total.** Add lines 9a through 9f	10	
11	**Total tax.** Add lines 7, 8, and 10. Enter here and on page 1, line 31	11	221,734.

Part II — Section 965 Payments (see instructions)

12	2018 net 965 tax liability paid from Form 965-B, Part II, column (k), line 2. Enter here and on page 1, line 32	12	

Part III — Payments and Refundable Credits, and Section 965 Net Tax Liability

13	2017 overpayment credited to 2018	13	
14	2018 estimated tax payments	14	224,000.
15	2018 refund applied for on Form 4466	15	
16	Combine lines 13, 14, and 15	16	224,000.
17	Tax deposited with Form 7004	17	
18	Withholding (see instructions)	18	
19	**Total payments.** Add lines 16, 17, and 18	19	224,000.
20	Refundable credits from:		
a	Form 2439 — 20a		
b	Form 4136 — 20b		
c	Form 8827, line 8c — 20c		
d	Other (attach statement — see instructions) — 20d		
21	**Total credits.** Add lines 20a through 20d	21	
22	2018 net 965 tax liability from Form 965-B, Part I, column (d), line 2. See instructions	22	
23	**Total payments, credits, and section 965 net tax liability.** Add lines 19, 21, and 22. Enter here and on page 1, line 33	23	224,000.

Schedule K **Other Information** (see instructions)

		Yes	No
1	Check accounting method: a ☐ Cash b ☒ Accrual c ☐ Other (specify) ►		
2	See the instructions and enter the:		
	a Business activity code no. ►		
	b Business activity ► Retail		
	c Product or service ► Pet Supplies		
3	Is the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group? If "Yes," enter name and EIN of the parent corporation ►		X
4	At the end of the tax year:		
	a Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part I of Schedule G (Form 1120) (attach Schedule G)		X
	b Did any individual or estate own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part II of Schedule G (Form 1120) (attach Schedule G)	X	
5	At the end of the tax year, did the corporation:		
	a Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation not included on **Form 851,** Affiliations Schedule? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.		X

(i) Name of Corporation	**(ii)** Employer Identification Number (if any)	**(iii)** Country of Incorporation	**(iv)** Percentage Owned in Voting Stock

		Yes	No
	b Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.		X

[DO NOT FILE]

(i) Name of Entity	**(ii)** Employer Identification Number (if any)	**(iii)** Country of Organization	**(iv)** Maximum Percentage Owned in Profit, Loss, or Capital

		Yes	No
6	During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? See sections 301 and 316. If "Yes," file **Form 5452**, Corporate Report of Nondividend Distributions. See the instructions for Form 5452. If this is a consolidated return, answer here for the parent corporation and on Form 851 for each subsidiary.		X
7	At any time during the tax year, did one foreign person own, directly or indirectly, at least 25% of the total voting power of all classes of the corporation's stock entitled to vote or at least 25% of the total value of all classes of the corporation's stock? For rules of attribution, see section 318. If "Yes," enter:		X
	(a) Percentage owned ► and **(b)** Owner's country ►		
	(c) The corporation may have to file **Form 5472,** Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Enter the number of Forms 5472 attached ►		
8	Check this box if the corporation issued publicly offered debt instruments with original issue discount ► ☐ If checked, the corporation may have to file **Form 8281,** Information Return for Publicly Offered Original Issue Discount Instruments.		
9	Enter the amount of tax-exempt interest received or accrued during the tax year ► $ 15,000.		
10	Enter the number of shareholders at the end of the tax year (if 100 or fewer) ► 2		
11	If the corporation has an NOL for the tax year and is electing to forego the carryback period, check here (see instructions) ► ☐ If the corporation is filing a consolidated return, the statement required by Regulations section 1.1502-21(b)(3) must be attached or the election will not be valid.		
12	Enter the available NOL carryover from prior tax years (do not reduce it by any deduction reported on page 1, line 29a.) ► $ None		

Schedule K **Other Information** *(continued from page 4)*

		Yes	No
13	Are the corporation's total receipts (page 1, line 1a, plus lines 4 through 10) for the tax year **and** its total assets at the end of the tax year less than $250,000?		X
	If "Yes," the corporation is not required to complete Schedules L, M-1, and M-2. Instead, enter the total amount of cash distributions and the book value of property distributions (other than cash) made during the tax year ►$		
14	Is the corporation required to file Schedule UTP (Form 1120), Uncertain Tax Position Statement? See instructions. If "Yes," complete and attach Schedule UTP.		X
15a	Did the corporation make any payments in 2018 that would require it to file Form(s) 1099?		X
b	If "Yes," did or will the corporation file required Forms 1099?		
16	During this tax year, did the corporation have an 80% or more change in ownership, including a change due to redemption of its own stock?		X
17	During or subsequent to this tax year, but before the filing of this return, did the corporation dispose of more than 65% (by value) of its assets in a taxable, non-taxable, or tax deferred transaction?		X
18	Did the corporation receive assets in a section 351 transfer in which any of the transferred assets had a fair market basis or fair market value of more than $1 million?		X
19	During the corporation's tax year, did the corporation make any payments that would require it to file Forms 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474) of the Code?		X
20	Is the corporation operating on a cooperative basis?		X
21	During the tax year, did the corporation pay or accrue any interest or royalty for which the deduction is not allowed under section 267A? See instructions		X
	If "Yes," enter the total amount of the disallowed deductions ►$		
22	Does the corporation have gross receipts of at least $500 million in any of the 3 preceding tax years? (See sections 59A(e)(2) and (3))		X
	If "Yes," complete and attach Form 8991.		
23	Did the corporation have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions		X
24	Does the corporation satisfy one of the following conditions and the corporation does not own a pass-through entity with current year, or prior year carryover, excess business interest expense? See instructions	X	
a	The corporation's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year do not exceed $25 million, and the corporation is not a tax shelter, or		
b	The corporation only has business interest expense from (1) an electing real property trade or business, (2) an electing farming business, or (3) certain utility businesses under section 163(j)(7). If "No," complete and attach Form 8990.		
25	Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund?		X
	If "Yes," enter amount from Form 8996, line 13 ►$		

Schedule L — Balance Sheets per Books

Assets	Beginning of tax year (a)	Beginning of tax year (b)	End of tax year (c)	End of tax year (d)
1 Cash		1,200,000.		1,039,461.
2a Trade notes and accounts receivable	2,062,500.		2,147,000.	
b Less allowance for bad debts		2,062,500.		2,147,000.
3 Inventories		2,750,000.		3,030,000.
4 U.S. government obligations				
5 Tax-exempt securities (see instructions)		375,000.		375,000.
6 Other current assets (attach statement) See St 1		1,525,000.		1,527,266.
7 Loans to shareholders				
8 Mortgage and real estate loans				
9 Other investments (attach statement)				
10a Buildings and other depreciable assets	5,455,000.		5,455,000.	
b Less accumulated depreciation	606,000.	4,849,000.	712,000.	4,743,000.
11a Depletable assets				
b Less accumulated depletion				
12 Land (net of any amortization)				
13a Intangible assets (amortizable only)				
b Less accumulated amortization				
14 Other assets (attach statement) See St 2		952,500.		941,000.
15 Total assets		13,714,000.		13,802,727.
Liabilities and Shareholders' Equity				
16 Accounts payable		2,284,000.		1,840,711.
17 Mortgages, notes, bonds payable in less than 1 year		4,625,000.		4,575,000.
18 Other current liabilities (attach stmt) See St 3		175,000.		155,000.
19 Loans from shareholders				
20 Mortgages, notes, bonds payable in 1 year or more				
21 Other liabilities (attach statement)				
22 Capital stock: a Preferred stock				
b Common stock	2,500,000.	2,500,000.	2,500,000.	2,500,000.
23 Additional paid-in capital				
24 Retained earnings — Approp (att stmt)				
25 Retained earnings — Unappropriated		4,130,000.		4,732,016.
26 Adjmt to shareholders' equity (att stmt)				
27 Less cost of treasury stock				
28 Total liabilities and shareholders' equity		13,714,000.		13,802,727.

Schedule M-1 — Reconciliation of Income (Loss) per Books With Income per Return

Note: The corporation may be required to file Schedule M-3. See instructions.

1 Net income (loss) per books	852,016.	7 Income recorded on books this year not included on this return (itemize): Tax-exempt interest $ 15,000.	15,000.
2 Federal income tax per books	221,734.	8 Deductions on this return not charged against book income this year (itemize):	
3 Excess of capital losses over capital gains		a Depreciation $ 30,000.	
4 Income subject to tax not recorded on books this year (itemize):		b Charitable contribns $	30,000.
5 Expenses recorded on books this year not deducted on this return (itemize): a Depreciation $ b Charitable contributions $ c Travel & entertainment $ Statement 4 49,000.	49,000.	9 Add lines 7 and 8	45,000.
6 Add lines 1 through 5	1,122,750.	10 Income (page 1, line 28) — line 6 less line 9	1,077,750.

Schedule M-2 — Analysis of Unappropriated Retained Earnings per Books (Line 25, Schedule L)

1 Balance at beginning of year	4,130,000.	5 Distributions: a Cash	250,000.
2 Net income (loss) per books	852,016.	b Stock c Property	
3 Other increases (itemize):		6 Other decreases (itemize):	
		7 Add lines 5 and 6	250,000.
4 Add lines 1, 2, and 3	4,982,016.	8 Balance at end of year (line 4 less line 7)	4,732,016.

Form **1125-A**
(Rev. November 2018)
Department of the Treasury
Internal Revenue Service

Cost of Goods Sold

► **Attach to Form 1120, 1120-C, 1120-F, 1120S, or 1065.**
► **Go to *www.irs.gov/Form1125A* for the latest information.**

OMB No. 1545-0123

Name: Pet Kingdom, Inc.
Employer identification number: 11-1111112

1	Inventory at beginning of year	1	2,750,000.
2	Purchases	2	2,580,000.
3	Cost of labor	3	
4	Additional section 263A costs (attach schedule)	4	
5	Other costs (attach schedule)	5	
6	**Total.** Add lines 1 through 5	6	5,330,000.
7	Inventory at end of year	7	3,030,000.
8	**Cost of goods sold.** Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return. See instructions	8	2,300,000.

9 a Check all methods used for valuing closing inventory:

(i) [X] Cost

(ii) [X] Lower of cost or market

(iii) [ ] Other (Specify method used and attach explanation.) ►

b Check if there was a writedown of subnormal goods ► [ ]

c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ► [ ]

d If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO — **9d**

e If property is produced or acquired for resale, do the rules of section 263A apply to the entity? See instructions [ ] Yes [X] No

f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation [ ] Yes [X] No

BAA For Paperwork Reduction Act Notice, see instructions. Form **1125-A** (Rev. 11-2018)

CPCZ0401L 09/26/18

SCHEDULE G (Form 1120)
(Rev December 2011)
Department of the Treasury
Internal Revenue Service

Information on Certain Persons Owning the Corporation's Voting Stock

► Attach to Form 1120.
► See instructions.

OMB No. 1545-0123

Name	Employer identification number (EIN)
Pet Kingdom, Inc.	11-1111112

Part I **Certain Entities Owning the Corporation's Voting Stock.** (Form 1120, Schedule K, Question 4a). Complete columns (i) through (v) below for any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Percentage Owned in Voting Stock

Part II **Certain Individuals and Estates Owning the Corporation's Voting Stock.** (Form 1120, Schedule K, Question 4b). Complete columns (i) through (iv) below for any individual or estate that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Percentage Owned in Voting Stock
Janet Morton	123-45-6788	United States	50.00%
Kim Wong	123-45-6787	United States	50.00%

SCHEDULE M-3 (Form 1120)

Department of the Treasury
Internal Revenue Service

Net Income (Loss) Reconciliation for Corporations With Total Assets of $10 Million or More

► Attach to Form 1120 or 1120-C.
► Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123

2018

Name of corporation (common parent, if consolidated return): Pet Kingdom, Inc.

Employer identification number: 11-1111112

Check applicable box(es): (1) [X] Non-consolidated return (2) [ ] Consolidated return (Form 1120 only)
(3) [ ] Mixed 1120/L/PC group (4) [ ] Dormant subsidiaries schedule attached

Part I Financial Information and Net Income (Loss) Reconciliation (see instructions)

1 a Did the corporation file SEC Form 10-K for its income statement period ending with or within this tax year?
[ ] **Yes.** Skip lines 1b and 1c and complete lines 2a through 11 with respect to that SEC Form 10-K.
[X] **No.** Go to line 1b. See instructions if multiple non-tax-basis income statements are prepared.

b Did the corporation prepare a certified audited non-tax-basis income statement for that period?
[ ] **Yes.** Skip line 1c and complete lines 2a through 11 with respect to that income statement.
[X] **No.** Go to line 1c.

c Did the corporation prepare a non-tax-basis income statement for that period?
[X] **Yes.** Complete lines 2a through 11 with respect to that income statement.
[ ] **No.** Skip lines 2a through 3c and enter the corporation's net income (loss) per its books and records on line 4a.

2 a Enter the income statement period: Beginning 1/01/18 Ending 12/31/18

b Has the corporation's income statement been restated for the income statement period on line 2a?
[ ] **Yes.** (If 'Yes', attach an explanation and the amount of each item restated.)
[X] **No.**

c Has the corporation's income statement been restated for any of the five income statement periods immediately preceding the period on line 2a?
[ ] **Yes.** (If 'Yes', attach an explanation and the amount of each item restated.)
[X] **No.**

3 a Is any of the corporation's voting common stock publicly traded?
[ ] **Yes.**
[X] **No.** If 'No', go to line 4a.

b Enter the symbol of the corporation's primary U.S. publicly traded voting common stock . . . .

c Enter the nine-digit CUSIP number of the corporation's primary publicly traded voting common stock . . . .

4 a Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1	**4 a**	852,016.
b Indicate accounting standard used for line 4a (see instructions): (1) [X] GAAP (2) [ ] IFRS (3) [ ] Statutory (4) [ ] Tax-basis (5) [ ] Other (specify)		
5 a Net income from nonincludible foreign entities (attach statement)	**5 a**	
b Net loss from nonincludible foreign entities (attach statement and enter as a positive amount)	**5 b**	
6 a Net income from nonincludible U.S. entities (attach statement)	**6 a**	
b Net loss from nonincludible U.S. entities (attach statement and enter as a positive amount)	**6 b**	
7 a Net income (loss) of other includible foreign disregarded entities (attach statement)	**7 a**	
b Net income (loss) of other includible U.S. disregarded entities (attach statement)	**7 b**	
c Net income (loss) of other includible entities (attach statement)	**7 c**	
8 Adjustment to eliminations of transactions between includible entities and nonincludible entities (attach statement)	**8**	
9 Adjustment to reconcile income statement period to tax year (attach statement)	**9**	
10 a Intercompany dividend adjustments to reconcile to line 11 (attach statement)	**10 a**	
b Other statutory accounting adjustments to reconcile to line 11 (attach statement)	**10 b**	
c Other adjustments to reconcile to amount on line 11 (attach statement)	**10 c**	
11 Net income (loss) per income statement of includible corporations. Combine lines 4 through 10	**11**	852,016.

Note: Part I, line 11, must equal Part II, line 30, column (a), or Schedule M-1, line 1 (see instructions).

12 Enter the total amount (not just the corporation's share) of the assets and liabilities of all entities included or removed on the following lines.

	Total Assets	Total Liabilities
a Included on Part I, line 4 ►	13,714,000.	13,802,727.
b Removed on Part I, line 5 ►		
c Removed on Part I, line 6 ►		
d Included on Part I, line 7 ►		

Form **1125-E** (Rev October 2016)

Department of the Treasury
Internal Revenue Service

Compensation of Officers

► **Attach to Form 1120, 1120-C, 1120-F, 1120-REIT, 1120-RIC, or 1120S.**
► Information about Form 1125-E and its separate instructions is at ***www.irs.gov/form1125e.***

OMB No. 1545-0123

Name: Pet Kingdom, Inc.

Employer identification number: 11-1111112

Note: Complete Form 1125-E only if total receipts are $500,000 or more. See instructions for definition of total receipts.

1 (a) Name of officer	(b) Social security number	(c) Percent of time devoted to business	Percent of stock owned (d) Common	(e) Preferred	(f) Amount of compensation
Janet Morton	123-45-6788	000.00 %	50.00 %	0.00 %	262,500.
Kim Wong	123-45-6787	000.00 %	50.00 %	0.00 %	262,500.
		%	%	%	
		%	%	%	
		%	%	%	
		%	%	%	
		%	%	%	
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		%	%	%	
		%	%	%	
		%	%	%	
		%	%	%	

[DO NOT FILE]

2 Total compensation of officers	525,000.
3 Compensation of officers claimed on Form 1125-A or elsewhere on return	
4 Subtract line 3 from line 2. Enter the result here and on Form 1120, page 1, line 12 or the appropriate line of your tax return	525,000.

Statement 1
Form 1120, Schedule L, Line 6
Other Current Assets

	Beginning	Ending
Certificate of Deposit	$ 400,000.	$ 400,000.
Prepaid Federal Tax	0.	2,266.
Stock Investment	1,125,000.	1,125,000.
Total	$ 1,525,000.	$ 1,527,266.

Statement 2
Form 1120, Schedule L, Line 14
Other Assets

	Beginning	Ending
Land	$ 812,500.	$ 812,500.
Other Assets	140,000.	128,500.
Total	$ 952,500.	$ 941,000.

Statement 3
Form 1120, Schedule L, Line 18
Other Current Liabilities

	Beginning	Ending
Other Current Liabilities	$ 175,000.	$ 155,000.
Total	$ 175,000.	$ 155,000.

Statement 4
Form 1120, Schedule M-1, Line 5
Book Expenses Not Deducted

Interest	$ 9,000.
Officer Life Insurance Premiums	40,000.
Total	$ 49,000.

Pursuant to requirements by the Texas Comptroller's Office, certain required input must be present and correct before the tax program will generate printable Texas forms. Please resolve all Texas Critical Diagnostics reported on the Diagnostics tab so that Texas forms may be viewable in the tax program.

7011

Pursuant to requirements by the Texas Comptroller's Office, certain required input must be present and correct before the tax program will generate printable Texas forms. Please resolve all Texas Critical Diagnostics reported on the Diagnostics tab so that Texas forms may be viewable in the tax program.

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7011

This form is not available for this release.

This form is not available for this release.

Daniel B. and Freida C. Butler 111-11-1112

The Tax Reform Impact Summary displays a comparison of the actual 2017 and 2018 tax return amounts. Additional information will be noted on continuing pages when the amounts specific to this tax return may differ due to the Tax Cuts and Jobs Act.

	2017	2018
INCOME		
Total income	0	173,182
ADJUSTMENTS TO INCOME		
Total adjustments	0	0
Adjusted gross income	0	173,182
ITEMIZED DEDUCTIONS		
Taxes	0	1,366
Total itemized deductions	0	1,366
TAX COMPUTATION		
Standard deduction	12,700	24,000
Larger of itemized or standard deduction	0	24,000
Income prior to exemption deduction	0	149,182
Exemption deduction	0	0
Taxable income	0	149,182
Tax before credits	0	24,405
NONREFUNDABLE CREDITS		
Child tax credit/credit for other dependents	0	1,000
Total nonrefundable credits	0	1,000
Tax after credits	0	23,405
OTHER TAXES		
Total tax	0	23,405
PAYMENTS AND REFUNDABLE CREDITS		
Income tax withheld	0	23,400
Estimated tax payments	0	8,000
Total payments and refundable credits	0	31,400
REFUND OR AMOUNT DUE		
Amount overpaid	0	7,995
Amount refunded to you	0	7,995
Amount you owe	0	0
TAX RATES		
Marginal tax rate	0.0%	22.0%

TAX COMPUTATION

The Tax Cuts and Jobs Act increased the standard deduction from $12,700 in 2017, to $24,000 in 2018.

NONREFUNDABLE CREDITS

The Tax Cuts and Jobs Act added a new credit for other dependents of $500 per eligible dependent.

Daniel B. and Freida C. Butler 111-11-1112

INCOME	
Wages, salaries, tips, etc	160,000
Interest income	1,982
Dividend income	4,200
Rent, royalty, partnership, SCorp, trust	7,000
Total income	173,182
ADJUSTMENTS TO INCOME	
Total adjustments	0
Adjusted gross income	173,182
ITEMIZED DEDUCTIONS	
Taxes	1,366
Total itemized deductions	1,366
TAX COMPUTATION	
Standard deduction	24,000
Larger of itemized or standard deduction	24,000
Income prior to exemption deduction	149,182
Taxable income	149,182
Tax before credits	24,405
CREDITS	
Child tax credit & other dependent cr	1,000
Total credits	1,000
Tax after credits	23,405
OTHER TAXES	
Total tax	23,405
PAYMENTS	
Federal income tax withheld	23,400
Estimated tax payments	8,000
Total payments	31,400
REFUND OR AMOUNT DUE	
Amount overpaid	7,995
Amount refunded to you	7,995
Amount you owe	0
TAX RATES	
Marginal tax rate	22.0%

Daniel B. and Freida C. Butler 111-11-1112

FEDERAL ADJUSTED GROSS INCOME	
Federal adjusted gross income	173,182
ADDITIONS TO INCOME	
Int. on obligations of other states	900
Total additions	900
ADJUSTED GROSS INCOME	
Kentucky adjusted gross income	174,082
TAX AND TAX CREDITS	
Itemized/Standard deductions	5,060
Kentucky taxable income	169,022
Tax	8,452
Total tax liability	8,452
TAX PAYMENTS	
Total payments	0
REFUND OR AMOUNT DUE	
Additional tax due	8,452
Underpayment penalty (Form 2210-K)	953
Amount you owe	9,405
TAX RATES	
Marginal tax rate	5.0%

Form **1040** Department of the Treasury — Internal Revenue Service (99)

U.S. Individual Income Tax Return **2018**

OMB No. 1545-0074 | IRS Use Only — Do not write or staple in this space.

Filing status: ☐ Single ☒ Married filing jointly ☐ Married filing separately ☐ Head of household ☐ Qualifying widow(er)

Your first name and initial	Last name	Your social security number
Daniel B. Butler		111-11-1112

Your standard deduction: ☐ Someone can claim you as a dependent ☐ You were born before January 2, 1954 ☐ You are blind

If joint return, spouse's first name and initial	Last name	Spouse's social security number
Freida C. Butler		123-45-6780

Spouse standard deduction: ☐ Someone can claim your spouse as a dependent ☐ Spouse was born before January 2, 1954 ☒ Full-year health care coverage or exempt (see inst.)

☐ Spouse is blind ☐ Spouse itemizes on a separate return or you were dual-status alien

Home address (number and street). If you have a P.O. box, see instructions. Apt. no.

625 Oak Street

Presidential Election Campaign (see inst.) ☐ **You** ☐ **Spouse**

City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule 6.

Corbin, KY 40701

If more than four dependents, see inst. and ✓ here ► ☐

Dependents (see instructions):

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) ✓ if qualifies for (see inst.): Child tax credit	Credit for other dependents
Gina Butler	123-45-6788	Child	☐	☒
Sam Butler	123-45-6787	Child	☐	☒
			☐	☐
			☐	☐

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

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Manager	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Salesperson	

Paid Preparer Use Only

Preparer's name	Preparer's signature	PTIN	Firm's EIN	Check if:
	Self-Prepared			☐ 3rd Party Designee

Firm's name ► | Phone no. | ☐ Self-employed

Firm's address ►

BAA For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Form **1040** (2018)

FDIA0112L 10/02/18

Attach Form(s) W-2. Also attach Form(s) W-2G and 1099-R if tax was withheld.

1	Wages, salaries, tips, etc. Attach Form(s) W-2			1	160,000.
2a	Tax-exempt interest	2a	900.		
	b Taxable interest			2b	1,982.
3a	Qualified dividends	3a	4,200.		
	b Ordinary dividends			3b	4,200.
4a	IRAs, pensions, and annuities	4a			
	b Taxable amount			4b	
5a	Social security benefits	5a			
	b Taxable amount			5b	
6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22		7,000.	6	173,182.
7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 36, from line 6			7	173,182.
8	**Standard deduction or itemized deductions** (from Schedule A)			8	24,000.
9	Qualified business income deduction (see instructions)			9	
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter –0–			10	149,182.
11	**a** Tax (see inst.) 24,405. (check if any from: 1 ☐ Form(s) 8814 2 ☐ Form 4972 3 ☐ ______) **b Add** any amount from Schedule 2 and check here ► ☐			11	24,405.
12	**a** Child tax credit/credit for other dependents 1,000. **b Add** any amount from Schedule 3 and check here ► ☐			12	1,000.
13	Subtract line 12 from line 11. If zero or less, enter -0-			13	23,405.
14	Other taxes. Attach Schedule 4			14	
15	Total tax. Add lines 13 and 14			15	23,405.
16	Federal income tax withheld from Forms W-2 and 1099			16	23,400.
17	Refundable credits: **a** EIC (see inst.) ______ **b** Sch. 8812 ______ **c** Form 8863 ______ Add any amount from Schedule 5		8,000.	17	8,000.
18	Add lines 16 and 17. These are your total payments			18	31,400.

Standard Deduction for –
- Single or married filing separately, $12,000
- Married filing jointly or Qualifying widow(er), $24,000
- Head of household, $18,000
- If you checked any box under Standard deduction, see instructions.

Refund

19	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you **overpaid**		19	7,995.
20a	Amount of line 19 you want **refunded to you.** If Form 8888 is attached, check here ► ☐		20a	7,995.
► b	Routing number XXXXXXXXXX ► **c** Type: ☐ Checking ☐ Savings			
► d	Account number XXXXXXXXXXXXXXXXXXXXXXXXXX			
21	Amount of line 19 you want **applied to your 2019 estimated tax** ►	21		

Direct deposit? See instructions.

Amount You Owe

22	**Amount you owe.** Subtract line 18 from line 15. For details on how to pay, see instructions ►		22	
23	Estimated tax penalty (see instructions)	23		

SCHEDULE 1
(Form 1040)

Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

▶ **Attach to Form 1040.**
▶ **Go to *www.irs.gov/Form1040* for instructions and the latest information.**

OMB No. 1545-0074
2018
Attachment Sequence No. **01**

Name(s) shown on Form 1040	Your social security number
Daniel B. and Freida C. Butler	111-11-1112

Additional Income	1–9b	Reserved	1–9b	
	10	Taxable refunds, credits, or offsets of state and local income taxes	10	
	11	Alimony received	11	
	12	Business income or (loss). Attach Schedule C or C-EZ	12	
	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐	13	
	14	Other gains or (losses). Attach Form 4797	14	
	15a	Reserved	15b	
	16a	Reserved	16b	
	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	7,000.
	18	Farm income or (loss). Attach Schedule F	18	
	19	Unemployment compensation	19	
	20a	Reserved	20b	
	21	Other income. List type and amount	21	
	22	Combine the amounts in the far right column. If you don't have any adjustments to income, enter here and include on Form 1040, line 6. Otherwise, go to line 23	22	7,000.

Adjustments to Income	23	Educator expenses	23			
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	24			
	25	Health savings account deduction. Attach Form 8889	25			
	26	Moving expenses for members of the Armed Forces. Attach Form 3903	26			
	27	Deductible part of self-employment tax. Attach Schedule SE	27			
	28	Self-employed SEP, SIMPLE, and qualified plans	28			
	29	Self-employed health insurance deduction	29			
	30	Penalty on early withdrawal of savings	30			
	31a	Alimony paid **b** Recipient's SSN ▶	31a			
	32	IRA deduction	32			
	33	Student loan interest deduction	33			
	34	Reserved	34			
	35	Reserved	35			
	36	Add lines 23 through 35			36	0.

SCHEDULE 5 (Form 1040)

Department of the Treasury
Internal Revenue Service

Other Payments and Refundable Credits

▶ Attach to Form 1040.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074

2018

Attachment Sequence No. **05**

Name(s) shown on Form 1040: Daniel B. and Freida C. Butler

Your social security number: 111-11-1112

Other Payments and Refundable Credits

65	Reserved	65	
66	2018 estimated tax payments and amount applied from 2017 return	66	8,000.
67a	Reserved	67a	
b	Reserved	67b	
68-69	Reserved	68-69	
70	Net premium tax credit. Attach Form 8962	70	
71	Amount paid with request for extension to file (see instructions)	71	
72	Excess social security and tier 1 RRTA tax withheld	72	
73	Credit for federal tax on fuels. Attach Form 4136	73	
74	Credits from Form: a ☐ 2439 b ☐ Reserved c ☐ 8885 d ☐ ______	74	
75	Add the amounts in the far right column. These are your total **other payments and refundable credits.** Enter here and include on Form 1040, line 17	75	8,000.

BAA For Paperwork Reduction Act Notice, see your tax return instructions. **Schedule 5 (Form 1040) 2018**

SCHEDULE B (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Interest and Ordinary Dividends

► Go to *www.irs.gov/ScheduleB* for instructions and the latest information.
► Attach to Form 1040.

OMB No. 1545-0074

2018

Attachment Sequence No. **08**

Name(s) shown on return: Daniel B. and Freida C. Butler

Your social security number: 111-11-1112

Part I Interest

(See instructions and the instructions for Form 1040, line 2b.)

Note: If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

			Amount
1	List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see the instructions and list this interest first. Also, show that buyer's social security number and address ►	1	
	First Bank		382.
	Second Bank		1,600.
2	Add the amounts on line 1	2	1,982.
3	Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815	3	
4	Subtract line 3 from line 2. Enter the result here and on Form 1040, line 2b ►	4	1,982.

Note: If line 4 is over $1,500, you must complete Part III.

Part II Ordinary Dividends

(See instructions and the instructions for Form 1040, line 3b.)

Note: If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

			Amount
5	List name of payer ►	5	
	CSX		4,200.
6	Add the amounts on line 5. Enter the total here and on Form 1040, line 3b ►	6	4,200.

Note: If line 6 is over $1,500, you must complete Part III.

DO NOT FILE

Part III Foreign Accounts and Trusts

(See instructions.)

You must complete this part if you **(a)** had over $1,500 of taxable interest or ordinary dividends; **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

		Yes	No
7a	At any time during 2018, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		X
	If 'Yes,' are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements		
b	If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located ►		
8	During 2018, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If 'Yes,' you may have to file Form 3520. See instructions		X

Name(s) shown on return. Do not enter name and social security number if shown on Page 1.: Daniel B. and Freida C. Butler

Your social security number: 111-11-1112

Caution: The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

Part II Income or Loss From Partnerships and S Corporations

Note: If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you **must** check the box in column **(e)** on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which **any** amount is **not** at risk, you **must** check the box in column **(f)** on line 28 and attach **Form 6198** (see instructions).

27 Are you reporting any loss not allowed in a prior year due to the at-risk, excess farm loss, or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section . . . . . ☐ **Yes** ☒ **No**

28	**(a)** Name	**(b)** Enter **P** for partnership; **S** for S corporation	**(c)** Check if foreign partnership	**(d)** Employer identification number	**(e)** Check if basis computation is required	**(f)** Check if any amount is not at risk
A	Falcon Partnership	P				
B						
C						
D						

	Passive Income and Loss		Nonpassive Income and Loss			
	(f) Passive loss allowed (attach **Form 8582** if required)	**(g)** Passive income from **Schedule K-1**	**(h)** Nonpassive loss from **Schedule K-1**	**(i)** Section 179 expense deduction from **Form 4562**	**(j)** Nonpassive income from **Schedule K-1**
A		7,000.			
B					
C					
D					
29 a Totals		7,000.			
b Totals					

30 Add columns (h) and (k) of line 29a	30	7,000.
31 Add columns (g), (i), and (j) of line 29b	31	
32 **Total partnership and S corporation income or (loss).** Combine lines 30 and 31	32	7,000.

Part III Income or Loss From Estates and Trusts

33	**(a)** Name	**(b)** Employer ID no.
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach **Form 8582** if required)	**(d)** Passive income from **Schedule K-1**	**(e)** Deduction or loss from **Schedule K-1**	**(f)** Other income from **Schedule K-1**
A				
B				
34 a Totals				
b Totals				

35 Add columns (d) and (f) of line 34a	35	
36 Add columns (c) and (e) of line 34b	36	
37 **Total estate and trust income or (loss).** Combine lines 35 and 36	37	

Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs) — Residual Holder

38 **(a)** Name	**(b)** Employer identification number	**(c)** Excess inclusion from **Schedules Q**, line 2c (see instructions)	**(d)** Taxable income (net loss) from **Schedules Q**, line 1b	**(e)** Income from **Schedules Q,** line 3b

39 Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below	39	

Part V Summary

40 Net farm rental income or (loss) from **Form 4835**. Also, complete line 42 below	40	
41 **Total income or (loss).** Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Schedule 1 (Form 1040), line 17, or Form 1040NR, line 18 ►	41	7,000.

42 **Reconciliation of farming and fishing income.** Enter your **gross** farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120S), box 17, code AC; and Schedule K-1 (Form 1041), box 14, code F (see instructions)	42	
43 **Reconciliation for real estate professionals.** If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040 or Form 1040NR from all rental real estate activities in which you materially participated under the passive activity loss rules	43	

Form **8582**

Department of the Treasury
Internal Revenue Service (99)

Passive Activity Loss Limitations

► **See separate instructions.**
► **Attach to Form 1040 or Form 1041.**
► **Go to *www.irs.gov/Form8582* for instructions and the latest information.**

OMB No. 1545-1008

2018

Attachment Sequence No. **88**

Name(s) shown on return: Daniel B. and Freida C. Butler

Identifying number: 111-11-1112

Part I 2018 Passive Activity Loss

Caution: Complete Worksheets 1, 2, and 3 before completing Part I.

Rental Real Estate Activities With Active Participation (For the definition of active participation, see **Special Allowance for Rental Real Estate Activities** in the instructions.)

1a	Activities with net income (enter the amount from Worksheet 1, column (a))	1a			
b	Activities with net loss (enter the amount from Worksheet 1, column (b))	1b			
c	Prior years' unallowed losses (enter the amount from Worksheet 1, column (c))	1c			
d	Combine lines 1a, 1b, and 1c			1d	

Commercial Revitalization Deductions From Rental Real Estate Activities

2a	Commercial revitalization deductions from Worksheet 2, column (a)	2a			
b	Prior year unallowed commercial revitalization deductions from Worksheet 2, column (b)	2b			
c	Add lines 2a and 2b			2c	

All Other Passive Activities

3a	Activities with net income (enter the amount from Worksheet 3, column (a))	3a	7,000.		
b	Activities with net loss (enter the amount from Worksheet 3, column (b))	3b			
c	Prior years' unallowed losses (enter the amount from Worksheet 3, column (c))	3c			
d	Combine lines 3a, 3b, and 3c			3d	7,000.
4	Combine lines 1d, 2c, and 3d. If this line is zero or more, stop here and include this form with your return; all losses are allowed, including any prior year unallowed losses entered on line 1c, 2b, or 3c. Report the losses on the forms and schedules normally used			4	7,000.

If line 4 is a loss and:
- Line 1d is a loss, go to Part II.
- Line 2c is a loss (and line 1d is zero or more), skip Part II and go to Part III.
- Line 3d is a loss (and lines 1d and 2c are zero or more), skip Parts II and III and go to line 15.

Caution: If your filing status is married filing separately and you lived with your spouse at any time during the year, **do not** complete Part II or Part III. Instead, go to line 15.

Part II Special Allowance for Rental Real Estate Activities With Active Participation

Note: Enter all numbers in Part II as positive amounts. See instructions for an example.

5	Enter the **smaller** of the loss on line 1d or the loss on line 4			5	
6	Enter $150,000. If married filing separately, see instructions	6			
7	Enter modified adjusted gross income, but not less than zero (see instrs)	7	166,182.		
	Note: If line 7 is greater than or equal to line 6, skip lines 8 and 9, enter -0- on line 10. Otherwise, go to line 8.				
8	Subtract line 7 from line 6	8			
9	Multiply line 8 by 50% (0.50). **Do not** enter more than $25,000. If married filing separately, see instructions			9	
10	Enter the **smaller** of line 5 or line 9			10	0.

If line 2c is a loss, go to Part III. Otherwise, go to line 15.

Part III Special Allowance for Commercial Revitalization Deductions From Rental Real Estate Activities

Note: Enter all numbers in Part III as positive amounts. See the example for Part II in the instructions.

11	Enter $25,000 reduced by the amount, if any, on line 10. If married filing separately, see instructions	11	
12	Enter the loss from line 4	12	
13	Reduce line 12 by the amount on line 10	13	
14	Enter the **smallest** of line 2c (treated as a positive amount), line 11, or line 13	14	

Part IV Total Losses Allowed

15	Add the income, if any, on lines 1a and 3a and enter the total	15	
16	**Total losses allowed from all passive activities for 2018.** Add lines 10, 14, and 15. See instructions to find out how to report the losses on your tax return	16	

Caution: The worksheets must be filed with your tax return. Keep a copy for your records.

Worksheet 1 — For Form 8582, Lines 1a, 1b, and 1c (See instructions.)

Name of activity	Current year		Prior years	Overall gain or loss	
	(a) Net income (line 1a)	(b) Net loss (line 1b)	(c) Unallowed loss (line 1c)	(d) Gain	(e) Loss
Total. Enter on Form 8582, lines 1a, 1b, and 1c ►					

Worksheet 2 — For Form 8582, Lines 2a and 2b (See instructions.)

Name of activity	(a) Current year deductions (line 2a)	(b) Prior year unallowed deductions (line 2b)	(c) Overall loss
Total. Enter on Form 8582, lines 2a and 2b ►			

Worksheet 3 — For Form 8582, Lines 3a, 3b, and 3c (See instructions.)

Name of activity	Current year		Prior years	Overall gain or loss	
	(a) Net income (line 3a)	(b) Net loss (line 3b)	(c) Unallowed loss (line 3c)	(d) Gain	(e) Loss
Falcon Partnership	7,000.			7,000.	
Total. Enter on Form 8582, lines 3a, 3b, and 3c ►	7,000.				

Worksheet 4 — Use this worksheet if an amount is shown on Form 8582, line 10 or 14 (See instructions.)

Name of activity	Form or schedule and line number to be reported on (see instructions)	(a) Loss	(b) Ratio	(c) Special allowance	(d) Subtract column (c) from column (a)
Total ►			1.00		

Worksheet 5 — Allocation of Unallowed Losses (See instructions.)

Name of activity	Form or schedule and line number to be reported on (see instructions)	(a) Loss	(b) Ratio	(c) Unallowed loss
Total ►			1.00	

Worksheet 6 — Allowed Losses (See instructions.)

Name of activity	Form or schedule and line number to be reported on (see instructions)	(a) Loss	(b) Unallowed loss	(c) Allowed loss
Total . . . ►				0.

Worksheet 7 — Activities With Losses Reported on Two or More Forms or Schedules (See instructions.)

	(a)	(b)	(c) Ratio	(d) Unallowed loss	(e) Allowed loss
Name of activity:					
Form or schedule and line number to be reported on (see instructions):					
1 a Net loss plus prior year unallowed loss from form or schedule . . . ►					
b Net income from form or schedule . . . ►					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . ►					
Form or schedule and line number to be reported on (see instructions):					
1 a Net loss plus prior year unallowed loss from form or schedule . . . ►					
b Net income from form or schedule . . . ►					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . ►					
Form or schedule and line number to be reported on (see instructions):					
1 a Net loss plus prior year unallowed loss from form or schedule . . . ►					
b Net income from form or schedule . . . ►					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . ►					
Form or schedule and line number to be reported on (see instructions):					
1 a Net loss plus prior year unallowed loss from form or schedule . . . ►					
b Net income from form or schedule . . . ►					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . ►					
Total . . . ►		0.	1.00	0.	0.
Name of activity:					
Form or schedule and line number to be reported on (see instructions):					
1 a Net loss plus prior year unallowed loss from form or schedule . . . ►					
b Net income from form or schedule . . . ►					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . ►					
Form or schedule and line number to be reported on (see instructions):					
1 a Net loss plus prior year unallowed loss from form or schedule . . . ►					
b Net income from form or schedule . . . ►					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . ►					
Form or schedule and line number to be reported on (see instructions):					
1 a Net loss plus prior year unallowed loss from form or schedule . . . ►					
b Net income from form or schedule . . . ►					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . ►					
Form or schedule and line number to be reported on (see instructions):					
1 a Net loss plus prior year unallowed loss from form or schedule . . . ►					
b Net income from form or schedule . . . ►					
c Subtract line 1b from line 1a. If zero or less, enter -0- . . . ►					
Total . . . ►		0.	1.00	0.	0.

Daniel B. and Freida C. Butler 111-11-1112

Wage Schedule

Taxpayer - Employer	Wages	Federal W/H	FICA	Medi-care	State W/H	Local W/H
	74,000.	11,000.	4,588.	1,073.		
Total	74,000.	11,000.	4,588.	1,073.	0.	0.

Spouse - Employer	Wages	Federal W/H	FICA	Medi-care	State W/H	Local W/H
	86,000.	12,400.	5,332.	1,247.		
Total	86,000.	12,400.	5,332.	1,247.		0.
Grand Total	160,000.	23,400.	9,920.	2,320.	0.	0.

Form 1040, Line 2a
Tax-Exempt Interest

Payer	In-state municipal bonds	Private activity bonds	Total municipal bonds
City of Corbin			900.
	0.	0.	900.

Form 1040, Line 3a
Qualified Dividends

CSX	4,200.
Total	4,200.

Qualified Dividends and Capital Gain Tax Worksheet (Form 1040, Line 11)

1.	Enter the amount from Form 1040, line 10		149,182.
2.	Enter the amount from Form 1040, line 3a	4,200.	
3.	Are you filing Schedule D? [ ] Yes. Enter the smaller of line 15 or 16 of Schedule D, but do not enter less than zero [X] No. Enter the amount from Schedule 1, line 13	0.	
4.	Add lines 2 and 3	4,200.	
5.	If you are claiming investment interest expense on Form 4952, enter the amount from line 4g of that form. Otherwise enter zero.	0.	
6.	Subtract line 5 from line 4. If zero or less, enter zero.		4,200.
7.	Subtract line 6 from line 1. If zero or less, enter zero.		144,982.
8.	Enter: $38,600 if single or married filing separately, $77,200 if married filing jointly or qualifying widow(er), $51,700 if head of household		77,200.
9.	Enter the smaller of line 1 or line 8		77,200.
10.	Enter the smaller of line 7 or line 9		77,200.
11.	Subtract line 10 from line 9. This amount is taxed at 0%		0.
12.	Enter the smaller of line 1 or line 6		4,200.
13.	Enter the amount from line 11		0.
14.	Subtract line 13 from line 12		4,200.
15.	Enter: $425,800 if single, $239,500 if married filing separately, $479,000 if married filing jointly or qualifying widow(er), $452,400 if head of household.		479,000.
16.	Enter the smaller of line 1 or line 15		149,182.
17.	Add lines 7 and 11		144,982.
18.	Subtract line 17 from line 16. If zero or less, enter zero.		4,200.
19.	Enter the smaller of line 14 or line 18		4,200.
20.	Multiply line 19 by 15% (.15)		630.
21.	Add lines 11 and 19		4,200.
22.	Subtract line 21 from line 12		0.
23.	Multiply line 22 by 20% (.20)		0.
24.	Figure the tax on the amount on line 7. (Use the Tax Table or Tax Computation Worksheet)		23,775.
25.	Add lines 20, 23, and 24		24,405.
26.	Figure the tax on the amount on line 1. (Use the Tax Table or Tax Computation Worksheet)		24,699.
27.	Tax on all taxable income (including capital gain distributions). Enter the smaller of line 25 or line 26 here and on Form 1040, line 11		24,405.

Child Tax Credit and Credit for Other Dependents Worksheet (Form 1040, Line 12a)

```
 1. Number of qualifying children with required SSN from
    Form 1040, Dependents: 0 x $2,000                           0.
 2. Number of other dependents, including qualifying
    children without the required SSN from
    Form 1040, Dependents: 2 x $500                         1,000.
 3. Add lines 1 and 2                                                    1,000.
 4. Enter the amount from Form 1040, line 7.              173,182.
 5. Enter $400,000 if MFJ ($200,000 for all others)       400,000.
 6. Is line 4 more than the amount on line 5?
    NO  - Leave line 6 blank. Enter -0- on line 7.
    YES - Subtract line 5 from line 4.
          If the result is not a multiple of $1,000,
          increase it to the next multiple of $1,000.
 7. Multiply the amount on line 6 by 5% (.05).
    Enter the result.                                                        0.
 8. Is the amount on line 3 more than the amount
    on line 7?
    NO  - Stop. You can't take the child tax
          credit on Form 1040, line 12a. You
          also cannot take the additional child
          tax credit on Form 1040, line 17b.
    YES - Subtract line 7 from line 3.
          Enter the result.                                              1,000.
 9. Enter the amount from Form 1040, line 11.                           24,405.
10. Add the amounts from:
    Schedule 3, Line 48              0.
    Schedule 3, Line 49              0.
    Schedule 3, Line 50              0.
    Schedule 3, Line 51              0.
    Form 5695, Line 30               0.
    Form 8910, Line 15               0.
    Form 8936, Line 23               0.
    Schedule R, Line 22              0.
    Enter the total.                                            0.
11. Are the amounts on line 9 and 10 the same?
    YES - Stop. You can't take the credit because
          there is no tax to reduce.
    NO  - Subtract line 10 from line 9.                                 24,405.
12. Is the amount on line 8 more than the
    amount on line 11?
    YES - Enter the amount from line 11.
    NO  - Enter the amount from line 8.
    This is your Child Tax Credit and credit for other
    dependents. Enter on Form 1040, line 12a.                            1,000.
```

Federal Income Tax Withheld

	11,000.
	12,400.
Total	23,400.

K-1 Rec Wkshts, Page 1

This form is not available for this release.

This form is not available for this release.

2019 Estimated Tax Worksheet - Adjusted Gross Income

Income	This Year	Difference	Next Year
Wages	160,000.	0.	160,000.
Interest	1,982.	0.	1,982.
Ordinary dividends	4,200.	0.	4,200.
Rents, royalties, etc.	7,000.	0.	7,000.
Total income	173,182.	0.	173,182.

Additional Capital Gain Information	This Year	Difference	Next Year
Qualified dividends	4,200.	0.	4,200.

Estimated adjusted gross income 173,182.

2019 Estimated Tax Maximum Capital Gains Rate Tax Computation (line numbers are from Schedule D Tax Worksheet)

1.	Enter your taxable income for next year		149,182.
2.	Enter your qualified dividends for next year	4,200.	
3.	Form 4952, line 4g amount	0.	
4.	Form 4952, line 4e amount	0.	
5.	Subtract line 4 from line 3 (not less than zero)	0.	
6.	Subtract line 5 from line 2 (not less than zero)	4,200.	
7.	Enter the smaller of line 15 or 16 of Sch D	0.	
8.	Enter the smaller of line 3 or line 4	0.	
9.	Subtract line 8 from line 7 (not less than zero)	0.	
10.	Add lines 6 and 9	4,200.	
11.	Add lines 18 and 19 of Sch D	0.	
12.	Enter the smaller of line 9 or line 11	0.	
13.	Subtract line 12 from line 10		4,200.
14.	Subtract line 13 from line 1 (not less than zero)		144,982.
15.	Enter the tax bracket limit	77,200.	
16.	Enter the smaller of line 1 or line 15	77,200.	
17.	Enter the smaller of line 14 or line 16	77,200.	
18.	Subtract line 10 from line 1 (not less than zero)	144,982.	
19.	Enter the larger of line 17 or line 18	144,982.	
20.	Subtract line 17 from line 16. This is taxed at 0%	0.	
21.	Enter the smaller of line 1 or line 13	4,200.	
22.	Enter the amount from line 20	0.	
23.	Subtract line 22 from line 21 (not less than zero)	4,200.	
24.	Enter the high income threshold	479,000.	
25.	Enter the smaller of line 1 or line 24	149,182.	
26.	Add lines 19 and 20	144,982.	
27.	Subtract lines 26 from line 25 (not less than zero)	4,200.	
28.	Enter the smaller of line 23 or line 27	4,200.	
29.	Multiply line 28 by 15% (.15)		630.
30.	Add lines 22 and 28	4,200.	
31.	Subtract line 30 from line 21	0.	
32.	Multiply line 31 by 20% (.20)		0.
42.	Figure the tax on the amount on line 19		23,775.
43.	Add lines 29, 32, 38, 41, and 42		24,405.
44.	Figure the tax on the amount on line 1		24,699.
45.	Tax (enter the smaller of line 43 or line 44		24,405.

2019 Estimated Tax Worksheet - Alternative Minimum Tax

Alternative Minimum Taxable Income

1.	Enter amount from 1040ES Worksheet line 3 (if not itemizing, enter ES worksheet line 1 and go to line 7 below)	173,182.
7.	Tax refund	0.
8.	Dispositions, small bus. stock, and incentive stock options adj.	0.
9.	Other adjustments	0.
10.	Alternative minimum taxable income	173,182.

2019 Estimated Tax Worksheet - Alternative Minimum Tax (continued)

Alternative Minimum Tax

11. Exemption	109,400.
12. Subtract line 11 from line 10	63,782.
13. Tax	16,121.
14. Alternative minimum tax foreign tax credit	0.
15. Tentative minimum tax	16,121.
16. Tax from ES Worksheet	24,405.
17. Alternative minimum tax (line 15 minus line 16)	0.

Tax Computation Using Maximum Capital Gain Rates

18. Alternative minimum taxable income less exemption	63,782.
19. AMT long-term cap. gain, section 1250, and qualified dividends	4,200.
20. Income subject to 26%/28% AMT rates (line 18 minus line 19)	59,582.
21. Tax on 26% rate income (28% and subtract $3822 if high income)	15,491.
22. Capital gain income subject to 0% rate	0.
23. Tax on 0% capital gain income	0.
24. Capital gain income subject to 15% rate	4,200.
25. Tax on 15% capital gain income	630.
26. Capital gain income subject to 20% rate	0.
27. Tax on 20% capital gain income	0.
28. Capital gain income subject to 25% rate	0.
29. Tax on 25% capital gain income	0.
30. Add lines 21, 23, 25, 27, and 29	16,121.
31. Multiply line 18 by 26% (28% and subtract $3822 if high income)	16,583.
32. Total Tax (smaller of line 30 or line 31)	16,121.

2019 Estimated Tax Worksheet - Nonrefundable Credits

Total $ 0.

Form 1040-ES, Page 1

This form is not available for this release.

Form 1040-ES, Page 2

This form is not available for this release.

FDIL1901L 05/22/18

Form 1040-ES, Page 3

This form is not available for this release.

Form 1040-ES, Page 4

This form is not available for this release.

FORM
740
Commonwealth of Kentucky
Department of Revenue

KENTUCKY INDIVIDUAL INCOME TAX RETURN
Full-Year Residents Only

2018

Check if deceased: ☐ Spouse ☐ Taxpayer   For calendar year or other taxable year beginning , 2018, and ending , 20

A Spouse's Social Security Number	B Your Social Security Number
123-45-6780	111-11-1112

Name — Last, First, Middle Initial (Joint or combined return, give both names and initials.)

Butler Daniel B

Butler Freida C

Mailing Address (Number and Street including Apartment Number or P.O. Box)

625 Oak Street

City, Town or Post Office / State / ZIP Code

Corbin KY 40701

FILING STATUS (see instructions)

1 ☐ Single

2 ☒ *Married,* filing separately on this combined return. **(If both had income.)**

3 ☐ *Married,* filing joint return.

4 ☐ *Married,* filing separate returns. Enter spouse's Social Security number above and full name here.

Check if applicable:

☐ ***Amended*** *(Enclose copy of 1040X, if applicable.)*

POLITICAL PARTY FUND

Designating $2 will not change your refund or tax due.

	A Spouse		B Yourself	
Democratic	1	☐	4	☐
Republican	2	☐	5	☐
No Designation	3	☒	6	☒

INCOME/TAX

		A Spouse (*Use if Filing Status 2 is checked.*)	B Yourself (or Joint)
5	Enter amount from federal Form 1040, line 7. **(If total of Columns A and B is $33,383 or less, you may qualify for the Family Size Tax Credit. See instructions.)**	92,591.00	80,591.00
6	Additions from Schedule M, line 6	450.00	450.00
7	Add lines 5 and 6	93,041.00	81,041.00
8	Subtractions from Schedule M, line 15	00	00
9	Subtract line 8 from line 7. This is your **Kentucky Adjusted Gross Income**	93,041.00	81,041.00
10	**Itemizers:** Enter itemized deductions from Kentucky Schedule A. **Nonitemizers:** Enter **$2,530** in Columns A and/or B.	2,530.00	2,530.00
11	Subtract line 10 from line 9. This is your **Taxable Income**	90,511.00	78,511.00
12	**Tax Computation:** Multiply line 11 by 5% (.05) or from Schedule J ☐	4,526.00	3,926.00
13	Enter tax from Form 4972-K ☐; Schedule RC-R ☐; Schedule DS-R ☐; Angel Investor Recapture ☐	00	00
14	Add lines 12 and 13 and enter total here	4,526.00	3,926.00
15	Enter amounts from Schedule ITC, Section A, lines 24E and 24F	00	00
16	Subtract line 15 from line 14. If line 15 is larger than line 14, enter zero	4,526.00	3,926.00
17	Enter personal tax credit amounts from Schedule ITC, Section B, lines 3A and 3B **Note:** Use only if 65 or over, blind, or in Kentucky National Guard.	00	00
18	Subtract line 17 from line 16. If line 17 is larger than line 16, enter zero	4,526.00	3,926.00
19	Add tax amount(s) in Columns A and B, line 18 and enter here		8,452.00
20	Check the box that represents your total family size (**see instructions** before completing lines 20 and 21)		1 ☐ 2 ☐ 3 ☐ 4 ☒
21	Multiply line 19 by **Family Size Tax Credit** decimal amount _ _ _ _ _ (_ _0 %) from Schedule ITC		00
22	Subtract line 21 from line 19		8,452.00
23	Enter the **Education Tuition Tax Credit** from Form 8863-K		00
24	Subtract line 23 from line 22		8,452.00
25	Enter **Child and Dependent Care Credit** from federal Form 2441, line 9 ► ________ x **20%** (.20)		00
26	**Income Tax Liability.** Subtract line 25 from line 24. If line 25 is larger than line 24, enter zero		8,452.00
27	**Enter KENTUCKY USE TAX due on Internet, mail order, or other out-of-state purchases (see instructions)**		00
28	Add lines 26 and 27. Enter here and on page 2, line 29		8,452.00

Daniel B. and Freida C. 111-11-1112

REFUND/TAX PAYMENT SUMMARY

29	Enter amount from page 1, line 28. This is your **Total Tax Liability**		29	8,452.00
30	**For amended return**; overpayment, if any, shown on original return		30	00
31	Add lines 29 and 30, enter here		31	8,452.00
32a	Enter **Kentucky income tax withheld** as shown on **enclosed** Schedule KW-2	32a 00		
b	Enter 2018 Kentucky estimated tax payments	32b 00		
c	Enter 2018 refundable certified rehabilitation credit	32c 00		
d	**For amended return;** enter amount paid with original return plus additional payment(s) made after it was filed	32d 00		
33	Add lines 32(a) through 32(d)		33	00
34	If line 31 is larger than line 33, subtract line 33 from line 31, enter **ADDITIONAL TAX DUE**		34	8,452.00
35a	Estimated tax penalty ☒ *Check if Form 2210-K attached*	35a 592.00		
b	Estimated tax interest	35b 361.00		
c	Interest	35c 00		
d	Late payment penalty	35d 00		
e	Late filing penalty	35e 00		
36	Add lines 35(a) through 35(e). Enter here		36	953.00
37	If the total of lines 31 and 36 are more than line 33, subtract line 33 from the total of lines 31 and 36. This is the **AMOUNT YOU OWE**	OWE	37	9,405.00
38	If line 33 is more than line 31, subtract lines 31 and 36 from line 33 This is the **AMOUNT YOU OVERPAID**		38	00

39 *Fund Contributions; see instructions.*

a Nature and Wildlife Fund	00	e Farms to Food Banks Trust Fund	00
b Child Victims' Trust Fund	00	f Local History Trust Fund	00
c Veterans' Program Trust Fund	00	g Special Olympics Kentucky	00
d Breast Cancer Research/ Education Trust Fund	00	h Pediatric Cancer Research Trust Fund	00
		i Rape Crisis Center Trust Fund	00
		j Court Appointed Special Advocate Trust Fund	00

40	Add lines 39(a) through 39(j). Enter here		40	00
41	Amount of line 38 to be **CREDITED TO YOUR 2019 ESTIMATED TAX** **(Credit forwards not available for amended returns)**	CREDIT FORWARD	41	00
42	Subtract lines 40 and 41 from line 38. Amount to be **REFUNDED TO YOU**	REFUND	42	00

REFUND OPTIONS (Not available for amended returns)

Check here if you would like your refund issued on a Bank of America Prepaid Debit Card ☐

Check here if you would like to receive your Debit Card material in Spanish ☐

I, the undersigned, declare under penalties of perjury that I have examined this return, including all accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete. I also understand and agree that our election to file a combined return under the provisions of Regulation 103 KAR 17:020 will result in refunds being made payable to us jointly and in each of us being jointly and severally liable for all taxes accruing under this return.

Sign Here	Your Signature (If joint or combined return, both must sign.)	Driver's License/State Issued ID No.	Date	Telephone Number (daytime)
	Spouse's Signature	Driver's License/State Issued ID No.	Date	
Paid Preparer Use	Signature of Preparer: Self-Prepared		Date	
	Name of Preparer or Firm		I.D. Number of Preparer	
	Email	Telephone No.	May the DOR discuss this return with this preparer? ☒ Yes ☐ No	

Enclose	Include a complete copy of federal Form 1040, if you received farm, business, or rental income or loss. If not required, check here. ☐	**Refund or No Payment**	**Kentucky Department of Revenue** P.O. Box 856970 Louisville, KY 40285-6970
Payment	Check Payable: **Kentucky State Treasurer** E-Pay Options: **www.revenue.ky.gov** Include: Your Social Security number and "KY Income Tax - 2018"	**With Payment**	**Kentucky Department of Revenue** P.O. Box 856980 Louisville, KY 40285-6980

SCHEDULE M

Commonwealth of Kentucky
Department of Revenue

KENTUCKY FEDERAL ADJUSTED GROSS INCOME MODIFICATIONS

► **Enclose with Form 740**

2018

Enter name(s) as shown on tax return.	Your Social Security Number
Butler, Freida C.	123-45-6780
Butler, Daniel B.	111-11-1112

		A. Spouse (Use if Filing Status 2 is checked.)		B. Yourself (or Joint)
PART I ADDITIONS TO FEDERAL ADJUSTED GROSS INCOME				
1 Enter interest income from bonds issued by other states and their political subdivisions	1	450.00	1	450.00
2 Enter resident adjustment from partnerships, fiduciaries and S corporations, Schedule K-1	2	00	2	00
3 Enter federal depreciation from Form 4562	3	00	3	00
4 Enter federal Net Operating Loss	4	00	4	00
5 Other additions (list and enter total): a ____ b ____ c ____	5	00	5	00
6 Total Additions. Enter here and on Form 740, page 1, line 6	6	450.00	6	450.00
PART II SUBTRACTIONS FROM FEDERAL ADJUSTED GROSS INCOME				
7 Enter state income tax refund or credit **reported** as income on federal Form 1040	7	00	7	00
8 Enter interest income from U.S. government bonds and securities	8	00	8	00
9 Enter excludable amount of retirement income (attach Schedule P if more than $31,110 per taxpayer)	9	00	9	00
10 Enter taxable amount of Social Security and Railroad Retirement Board benefits from federal Form 1040, line 5(b)	10	00	10	00
11 Enter resident adjustment from partnerships, fiduciaries and S corporations, Schedule K-1	11	00	11	00
12 Enter Kentucky depreciation from revised Form 4562	12	00	12	00
13 Enter Kentucky Net Operating Loss	13	00	13	00
14 Other subtractions (list and enter total): a ____ b ____ c ____	14	00	14	00
15 Total Subtractions. Enter here and on Form 740, page 1, line 8	15	00	15	00

FORM **2210-K**
Commonwealth of Kentucky
Department of Revenue

UNDERPAYMENT OF ESTIMATED TAX BY INDIVIDUALS

► **Enclose with Form 740 or 740-NP**

2018

Enter name(s) as shown on page 1, Form 740 or 740-NP.	Your Social Security Number
Daniel B. and Freida C. Butler	111-11-1112

PART I — EXCEPTIONS AND EXCLUSIONS

The penalty shall not apply if one of the following exceptions is met. If one or more of the following applies to you, check the appropriate box(es), complete any necessary blank(s) and check the "Form 2210-K attached" box located on Form 740, line 35(a) (Form 740-NP, line 35(a))

If none of the exceptions apply, go to Part II.

Check applicable box(es).

1 ☐ The taxpayer died during the taxable year.

2 ☐ The declaration was not required until after September 3, 2018, and the taxpayer files a return and pays the full amount of the tax computed on the return on or before February 1, 2019.

3 ☐ Two-thirds (2/3) or more of the gross income was from farming; this return is being filed on or before March 1, 2019; ***and*** the total tax due is being paid in full. Fiscal year taxpayers must file a return and pay the tax due on or before the first day of the third month following the close of the tax year.

a Enter total gross income	**3a**	
b Multiply by 2/3 (.67)	**3b**	
c Enter gross income from farming	**3c**	

Line (c) must ***equal or exceed*** line (b) to qualify for the exception.

4 ☐ Prepaid tax ***equals or exceeds*** last year's income tax liability.

a Enter the liability from the 2017 return, Form 740 or Form 740-NP, page 1, line 26	**4a**	
b Enter amount from the 2018 Form 740, line 33 (Form 740-NP, page 2, line 33)*	**4b**	

Line (b) must ***equal or exceed*** line (a) to claim the exception.

PART II — FIGURING THE UNDERPAYMENT AND PENALTY *(Complete Part II only if the **additional** tax due exceeds $500; otherwise, proceed to page 2, Part III.)*

1	**a** Enter 2018 income tax liability from Form 740, line 26 (Form 740-NP, page 1, line 26)	**1a**	8,452.
	b Enter credit for taxes paid to another state from Schedule ITC, Section A, line 5	**1b**	
	c Total (add lines 1(a) and 1(b))	**1c**	8,452.
2	Percentage of liability required to be prepaid is 70%	**2**	x .7
3	Multiply line 1(c) by line 2	**3**	5,916.
4	**a** Enter the amount from Form 740, line 33 (Form 740-NP, page 2, line 33)*	**4a**	
	b Enter credit for taxes paid to another state from Schedule ITC, Section A, line 5	**4b**	
	c Total (add lines 4(a) and 4(b))	**4c**	
5	Subtract line 4(c) from line 3 (If line 4(c) exceeds line 3, no penalty applies.)	**5**	5,916.
6	Penalty percentage is 10%	**6**	x .1
7	Multiply line 5 by line 6. This is the amount of the penalty for underpayment of estimated tax (minimum penalty $25). Enter here and on Form 740 or 740NP, line 35(a)	**7**	592.
8	Enter interest amount due from Form 2210-K, page 2, line 22. Enter here and on Form 740 or 740NP, line 35(b), if you have additional tax due	**8**	361.

To Avoid Underpayment Penalty in the Future, Obtain and File Form 740-ES.

* Do not include amounts prepaid with extension after the due date of the fourth declaration installment or amounts paid with the original return.

NOTE: **Use this page to calculate interest amount due on underpaid or untimely required estimated payments. See instructions for list of exclusions.**

PART III — REQUIRED ANNUAL PAYMENT

1	Enter 2018 income tax liability: (Form 740 or Form 740-NP, page 1, line 26)	1	8,452.
2	Enter 2018 income tax withheld and refundable credits: (Form 740 or Form 740-NP, page 2, line 32(a) and 32(c))	2	
3	Enter 2018 nonresident withholding: (Form 740-NP, page 2, line 32(d))	3	
4	Add lines 2 and 3. Enter total here	4	
5	Subtract line 4 from line 1. (If the result is $500 or less, stop here. Do not compute this schedule.)	5	8,452.
6	Enter 2017 income tax liability: (2017 Form 740 or Form 740-NP, page 1, line 26)	6	
7	Required annual payment. Enter the smaller of line 1 or line 6	7	8,452.

Note: If line 4 is equal to or greater than line 7, stop here. You do not owe interest.

PAYMENT DUE DATES		A 4-15-18	B 6-15-18	C 9-15-18	D 1-15-19
8 **Required Installments.** Enter 1/4 (.25) of line 7 in each column	8	2,113.	2,113.	2,113.	2,113.
9 **Estimated tax paid and tax withheld.** For column A only, enter the amount from line 9 on line 13. If line 9 is equal to or greater than line 8 for all payment periods (columns A through D), stop here. You do not owe interest. Complete lines 10 through 17 of each column before going to the next column	9				
10 Enter amount, if any, from line 17 of previous column	10				
11 Add lines 9 and 10. Enter here	11				
12 Enter the amount from line 16 of previous column	12		2,113.	4,226.	6,339.
13 Subtract line 12 from line 11. If zero or less, enter -0-. For column A only, enter the amount from line 9	13				
14 If the amount on line 13 is zero, subtract line 11 from line 12. Otherwise, enter zero	14		2,113.	4,226.	6,339.
15 **Underpayment.** If line 8 is equal to or greater than line 13, subtract line 13 from line 8. Otherwise, go to line 17	15	2,113.	2,113.	2,113.	2,113.
16 Add lines 14 and 15. Enter here. If line 8 is equal to or greater than line 13, then go to line 10 of the next column	16	2,113.	4,226.	6,339.	8,452.
17 **Overpayment.** If line 13 is more than line 8, subtract line 8 from line 13, then go to line 10 of the next column	17				
FIGURING THE INTEREST					
18 Interest calculation payment date	18	6-15-18	9-15-18	1-15-19	4-15-19
19 Number of days **from** the payment due date shown at the top of the column above line 8 **to** the date the amount on line 16 was paid, or the date shown for that column on line 18, whichever is earlier	19	See Attached Worksheet			
20 Annual Percentage Rate (APR)	20	.06	.06	.06 / .07	.07
21 Underpayment from line 16 X Number of days from line 19 / 365 X APR on line 20	21				
22 **INTEREST DUE**: Add amounts on line 21 columns A through D. Enter the total here and on Form 2210-K, page 1, line 8	22				361.

2018 **Underpayment Penalty Worksheet**

Daniel B. and Freida C. Butler **111-11-1112**

Required Installment	Payment			Penalty				
	Date	Type *	Amount	Underpayment	Days Late	Rate	Amount of Penalty **	Penalty per Period
First Qtr								
2,113.	4/15/18			2,113.	260	0.060	90.31	
Total								90.31
Rate Change	12/31/18			2,113.	105	0.070	42.55	
	4/15/19	5	2,113.					
Total								42.55
Second Qtr								
2,113.	6/15/18			2,113.	199	0.060	69.12	
Total								69.12
Rate Change	12/31/18			2,113.	105	0.070	42.55	
	4/15/19	5	2,113.					
Total								42.55
Third Qtr								
2,113.	9/15/18			2,113.	107	0.060	37.17	
Total								37.17
Rate Change	12/31/18			2,113.	105	0.070	42.55	
	4/15/19	5	2,113.					
Total								42.55
Fourth Qtr								
2,113.	1/15/19			2,113.	90	0.070	36.47	
	4/15/19	5	2,113.					
Total								36.47

TOTAL UNDERPAYMENT PENALTY .... 361.

* **1** = Overpayment
2 = Withholding
3 = Estimate
4 = Extension
5 = Paid with return

** Underpayment x $\frac{\textbf{Days Late}}{365}$ x Rate

FDIL1601L 05/22/18

Daniel B. and Freida C. Butler **111-11-1112**

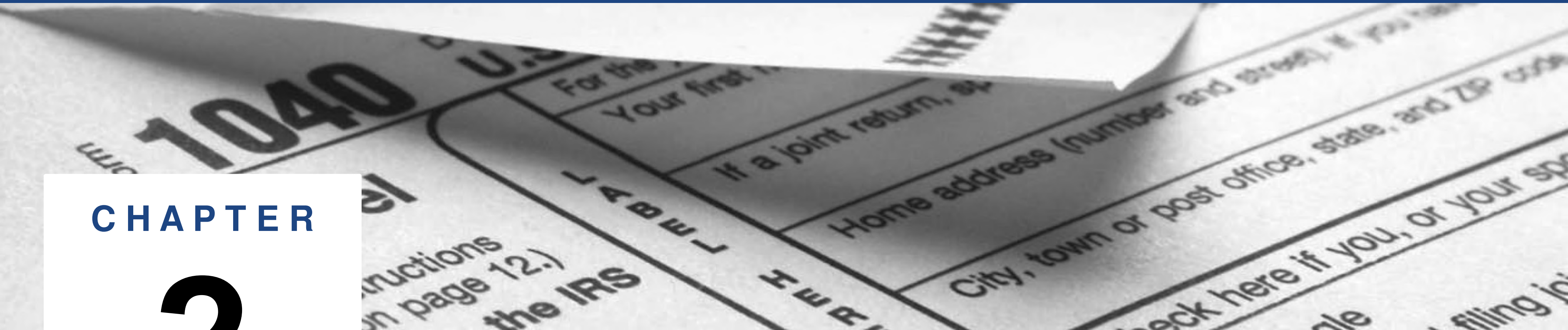
Estimated Tax Worksheet

		A Spouse	B Taxpayer
1.	State 2018 Adjusted gross income	93,041.	81,041.
2.	Increase in State AGI		
3.	Decrease in State AGI		
4.	State AGI expected in 2019	93,041.	81,041.
5.	Deductions/exemptions expected in 2019	2,530.	2,530.
6.	Expected taxable income	90,511.	78,511.
7a.	Estimated tax expected in 2019	4,526.	3,926.
7b.	Total of line 7a (columns A and B) (Based on 2018 tax rates)		8,452.
8.	Additional taxes		0.
9.	Credits expected in 2019		0.
10.	Total estimated tax expected in 2019 (line 7 plus line 8 less line 9)		8,452.
11.	Total required estimated tax (Based on 100% of 2019 tax)		8,452.
12.	Income tax withholding expected in 2019		0.
13.	Net required estimated tax (ln 10 less ln 11)		8,452.
14.	2018 overpayment applied to 2019		0.
15.	Estimated tax due (line 13 less line 14)		8,452.

Form 740-ES, Page 1

This form is not available for this release.

This form is not available for this release.



CHAPTER

2

Working With The Tax Law

Comprehensive Volume

SOUTH-WESTERN FEDERAL TAXATION

The Big Picture (slide 1 of 2)

- Early in November 2018, Fred and Megan scheduled a meeting with you to discuss a potential tax problem.
  - Fred and Megan purchased a 40-acre parcel of property in 2013 for $195,000.
    - On it, they built their “dream home” in 2014.
  - In March 2018, while walking on a remote part of their property, they spotted something shiny on the ground.
    - They started digging and eventually unearthed eight metal cans containing more than 1,400 rare gold coins in $5, $10, and $20 denominations dated from 1846 to 1895.
    - The face value of the gold coins is about $28,000, and the coins are in mint condition

The Big Picture (slide 2 of 2)

- Their delay in coming to you for tax advice was due to a state law that required their discovery to be turned over to the state for disposition.
  - The state, for a period of six months, was required to publicize the find and ask if anyone could prove ownership.
  - When no one came forward, the coins were returned to the Martels in October 2018.
- As they are now the rightful owners of the coins, they want to know the tax implications (if any) of their discovery.

Statutory Sources of Tax Law
(slide 1 of 2)

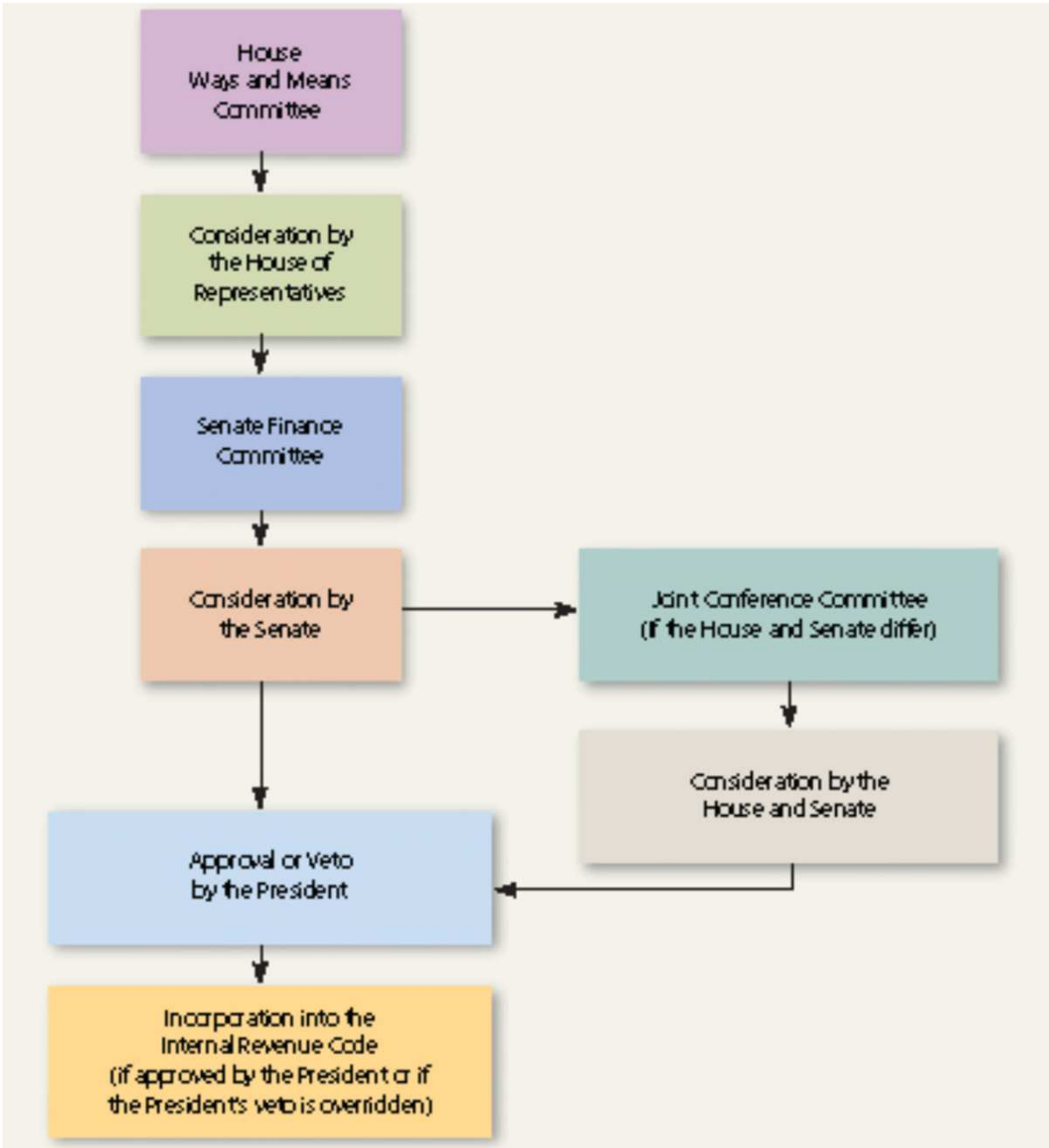
- Internal Revenue Code
  - Codification of the Federal tax law provisions in a logical sequence
  - We have had three “codifications”:
    - 1939, 1954, 1986

Statutory Sources of Tax Law
(slide 2 of 2)

- Example of Code Citation: § 2(a)(1)(A)

§	=	Abbreviation for "Section"
2	=	Section number
(a)	=	Subsection
(1)	=	Paragraph designation
(A)	=	Subparagraph designation

Legislative Process For Tax Bills



Administrative Sources of Tax Law (slide 1 of 2)

- Treasury Department Regulations
- Revenue Rulings
- Revenue Procedures, and
- Various other administrative pronouncements

Administrative Sources of Tax Law (slide 2 of 2)

Source	Location	Authority
Regulations	*Federal Register*	Force and effect of law.
Temporary Regulations	*Federal Register* *Internal Revenue Bulletin* *Cumulative Bulletin**	May be cited as a precedent.
Proposed Regulations	*Federal Register* *Internal Revenue Bulletin* *Cumulative Bulletin**	Preview of final Regulations.
Revenue Rulings Revenue Procedures Treasury Decisions Actions on Decisions	*Internal Revenue Bulletin* *Cumulative Bulletin**	Do not have the force and effect of law.
General Counsel Memoranda Technical Advice Memoranda	Tax Analysts' *Tax Notes*; Thomson Reuters *Checkpoint***; Commerce Clearing House *IntelliConnect*	May not be cited as a precedent.
Letter Rulings	Thomson Reuters and Commerce Clearing House tax services	Applicable only to taxpayer addressed. No precedential force.

*Through 2008, the contents of *Internal Revenue Bulletins* were consolidated semiannually into a *Cumulative Bulletin*. Beginning in 2009, the IRS decided to stop producing a *Cumulative Bulletin* as all *Internal Revenue Bulletins* are available electronically on the IRS website.

**Thomson Reuters *Checkpoint* includes a wide variety of tax resources. The most significant are materials produced by the Research Institute of America (RIA), including the *Federal Tax Coordinator 2d*.

Regulations (slide 1 of 4)

- Issued by U.S. Treasury Department
- Provide general interpretations and guidance in applying the Code

Regulations (slide 2 of 4)

- **Issued as:**
  - *Proposed:* Preview of final regulations
    - Do not have force and effect of law
  - *Temporary:* Issued when guidance needed quickly
    - Same authoritative value as final regulations
  - *Final:*
    - Force and effect of law

Regulations (slide 3 of 4)

- Example of Regulation citation:
  - Reg. § 1.2
    - Refers to Regulations under Code § 2
    - Subparts may be added for further identification
    - The numbering patterns of these subparts often have no correlation with the Code subsections

Regulations (slide 4 of 4)

- Example of Proposed Regulation citation:
  - Prop. Reg. § 1.2
- Example of Temporary Regulation citation:
  - Temp. Reg. § 1.6081–8T

Revenue Rulings (slide 1 of 2)

- Officially issued by National Office of IRS
  - Provide specific interpretations and guidance in applying the Code
  - Less legal force than Regulations
  - Issued in weekly Internal Revenue Bulletins

Revenue Rulings (slide 2 of 2)

- Example of Temporary Revenue Ruling citation
  - Rev. Rul. 2017–16, 2017–35 I.R.B. 215.
    - Explanation: Revenue Ruling Number 16, appearing on page 215 of the 35th weekly issue of the Internal Revenue Bulletin for 2017.

Revenue Procedures (slide 1 of 2)

- Concerned with the internal management practices and procedures of the IRS
  - For example, how to request a change in accounting method
  - Issued in weekly Internal Revenue Bulletins

Revenue Procedures (slide 2 of 2)

- Example of an older Revenue Procedure citation
  - Rev. Proc. 92-29, 1992-1 CB 748
    - 29th Rev. Procedure in 1992 found in volume 1 of Cumulative Bulletin on page 748
    - Note: The IRS stopped the publication of Cumulative Bulletins in 2008. All rulings and procedures are now published in Internal Revenue Bulletins, normally issued each week by the IRS.

Letter Rulings (slide 1 of 2)

- Offer guidance to taxpayer on how a transaction will be taxed before proceeding with it
  - Issued for a fee upon a taxpayer's request
  - Describe how the IRS will treat a proposed transaction
- Apply only to the taxpayer who asks for and obtains the ruling
  - Post-1984 letter rulings may be substantial authority for purposes of the accuracy-related penalty
- Limited to restricted, preannounced areas of taxation

Letter Rulings (slide 2 of 2)

- Example of Letter Ruling citation
  - Ltr. Rul. 201734004
  - 4th ruling issues in the 34th week of 2017

Other Administrative Pronouncements
(slide 1 of 3)

- Treasury Decisions - Issued by the Treasury Department to:
  - Promulgate new or amend existing Regulations
  - Announce position of the Government on selected court decisions
  - Published in the Internal Revenue Bulletin

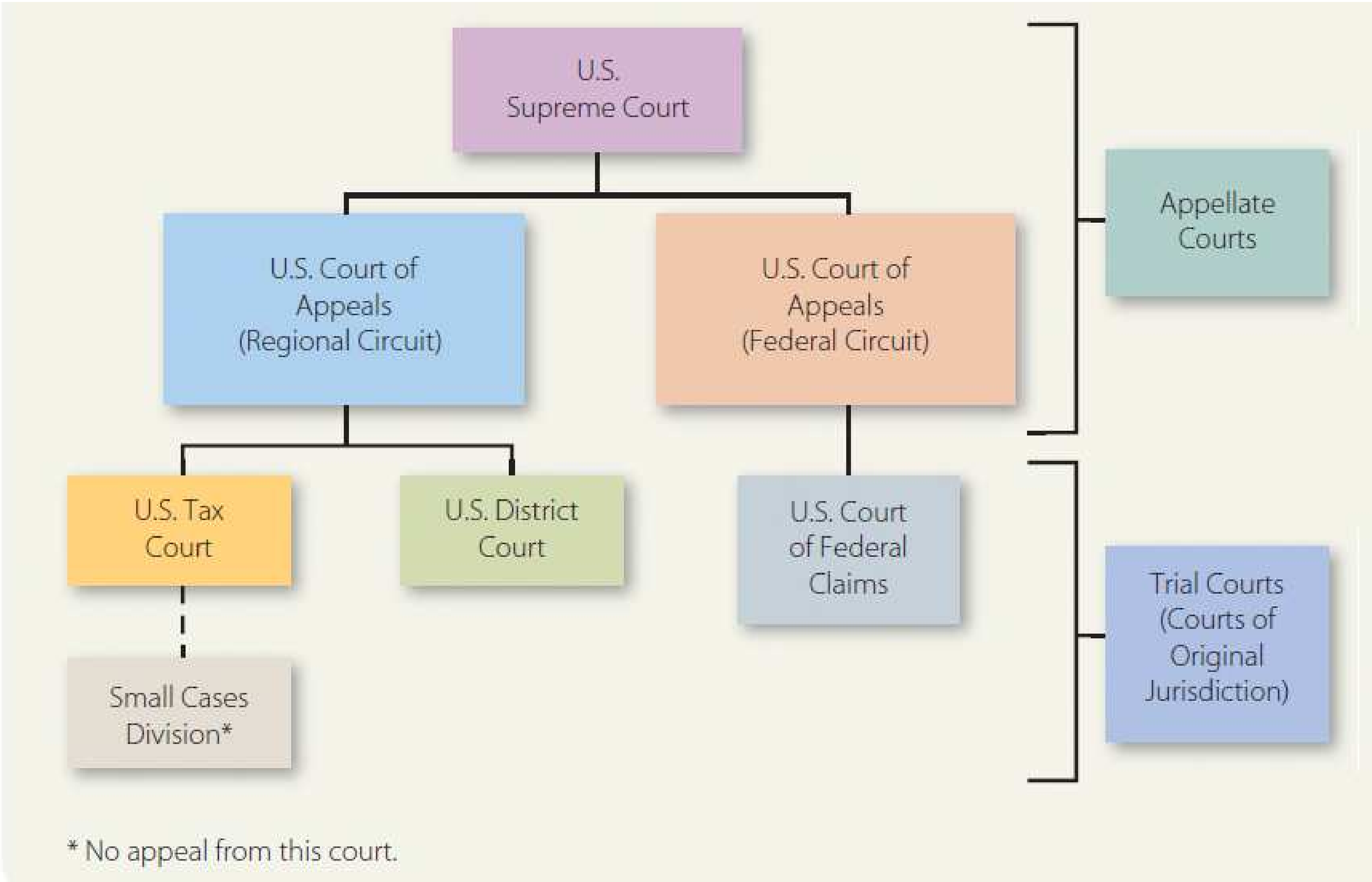
Other Administrative Pronouncements
(slide 2 of 3)

- Determination Letters
  - Issued by Area Director at taxpayer’s request
  - Usually involve completed transactions
  - Not published
    - Made known only to party making the request

Other Administrative Pronouncements
(slide 3 of 3)

- A variety of internal memoranda that constitute the working law of the IRS also are released but not officially published, such as
  – General Counsel Memoranda (GCMs)
  – Technical Advice Memoranda (TAMs)
  – Internal Legal Memoranda (ILMs)
  – Field Service Advice Memoranda (FSAs)
- The IRS indicates that they may not be cited as precedents by taxpayers
  – However, these working documents do explain the IRS's position on various issues.

Federal Judicial System



Judicial Sources (slide 1 of 2)

- There are four courts of original jurisdiction (trial courts)
  - U.S. Tax Court: Regular
  - U.S. Tax Court: Small Cases Division
  - Federal District Court
  - U.S. Court of Federal Claims

Judicial Sources (slide 2 of 2)

Concept Summary 2.1

Federal Judicial System: Trial Courts

Issue	U.S. Tax Court	U.S. District Court	U.S. Court of Federal Claims
Number of judges per court	19*	Varies	16
Payment of deficiency before trial	No	Yes	Yes
Jury trial available	No	Yes	No
Types of disputes	Tax cases only	Most criminal and civil issues	Claims against the United States
Jurisdiction	Nationwide	Location of taxpayer	Nationwide
IRS acquiescence policy	Yes	Yes	Yes
Appeal route	U.S. Court of Appeals	U.S. Court of Appeals	U.S. Court of Appeals for the Federal Circuit

*Currently, there are only 16 regular judges. They are assisted by 10 senior judges (whose terms have ended, but return to hear cases as needed) and 5 special trial judges (who are appointed by the Senior Judge of the U.S. Tax Court, rather than by the President) (February 2018).

Appeals Process

- Appeals from District Court or Tax Court go to the U.S. Court of Appeals for circuit where taxpayer resides
- Appeals from Court of Federal Claims is to Court of Appeals for the Federal Circuit
- Appeal to the Supreme Court is by *Writ of Certiorari*
  – Only granted for those cases the Supreme Court wants to hear; only a few every year

Courts' Weights As Precedents

- Precedential Weight (from High to Low):
  - Supreme Court
  - Circuit Court of Appeals
  - Tax Court (Regular), U.S. Court of Federal Claims, and U.S. District Courts
- Decisions of Small Cases Division of Tax Court have no precedential value and cannot be appealed

Tax Court (slide 1 of 3)

- Issues three types of decisions: Regular, Memorandum, and Summary Opinions
  - Regular decisions involve novel issues not previously resolved by the court
- Regular decisions are published by U.S. government, for example:

Temporary Citation	*Timothy M. Dees*, 148 T.C. _____, No. 1 (2017). *Explanation*: Page number left blank because not yet known.
Permanent Citation	*Timothy M. Dees*, 148 T.C. 1 (2017). *Explanation*: Page number now available.

- Summary opinions
  - Issued in small tax cases and may not be used as precedent in any other case

Tax Court (slide 2 of 3)

- Tax Court Memorandum decisions
  - Memorandum decisions deal with situations necessitating only the application of already established principles of law
  - Memorandum decisions were not published by the U.S. Government until recently

Tax Court (slide 3 of 3)

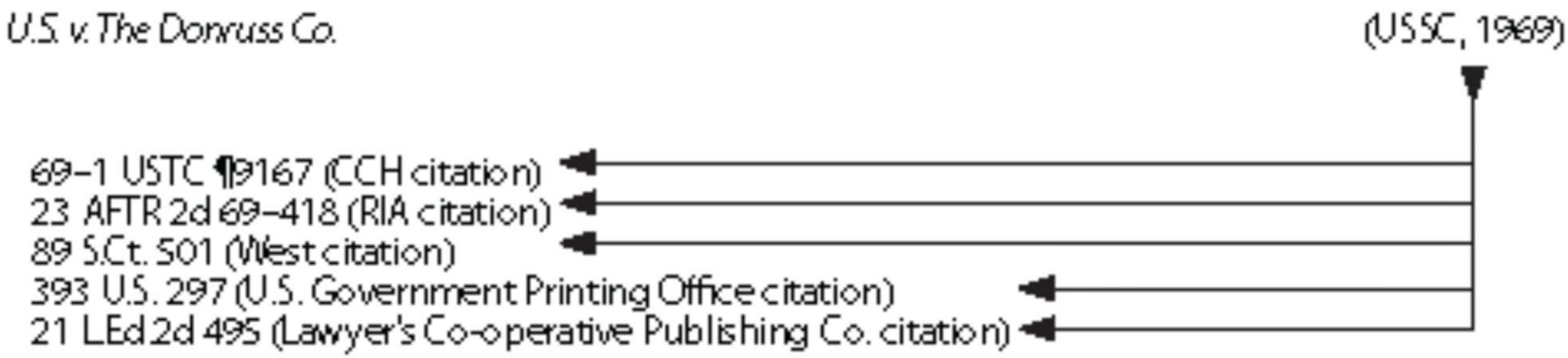
- Memorandum decisions were—and continue to be—published by several tax services
  - Consider, for example, three different ways that *Nick R. Hughes* can be cited:
    - *Nick R. Hughes*, T.C.Memo. 2009–94
      - The 94th Memorandum decision issued by the Tax Court in 2009
    - *Nick R. Hughes*, 97 TCM 1488
      - Page 1488 of Vol. 97 of the CCH Tax Court Memorandum Decisions
    - *Nick R. Hughes*, 2009 RIA T.C.Memo. ¶2009,094
      - Paragraph 2009,094 of the RIA T.C. Memorandum Decisions

Examples Of District Court Decision Citations

- *Turner v. U.S.*, 2004–1 USTC ¶60,478 (D.Ct. Tex., 2004) (CCH citation)
- *Turner v. U.S.*, 93 AFTR 2d 2004–686 (D.Ct. Tex., 2004) (RIA citation)
- *Turner v. U.S.*, 306 F.Supp.2d 668 (D.Ct. Tex., 2004) (West citation)

Supreme Court Decisions

- Examples of citations



Tax Treaties

- The U.S. signs tax treaties with foreign countries to:
  - Avoid double taxation
  - Render mutual assistance in tax enforcement
- Neither a tax law nor a tax treaty takes general precedence
  - When there is a direct conflict, the most recent item will take precedence

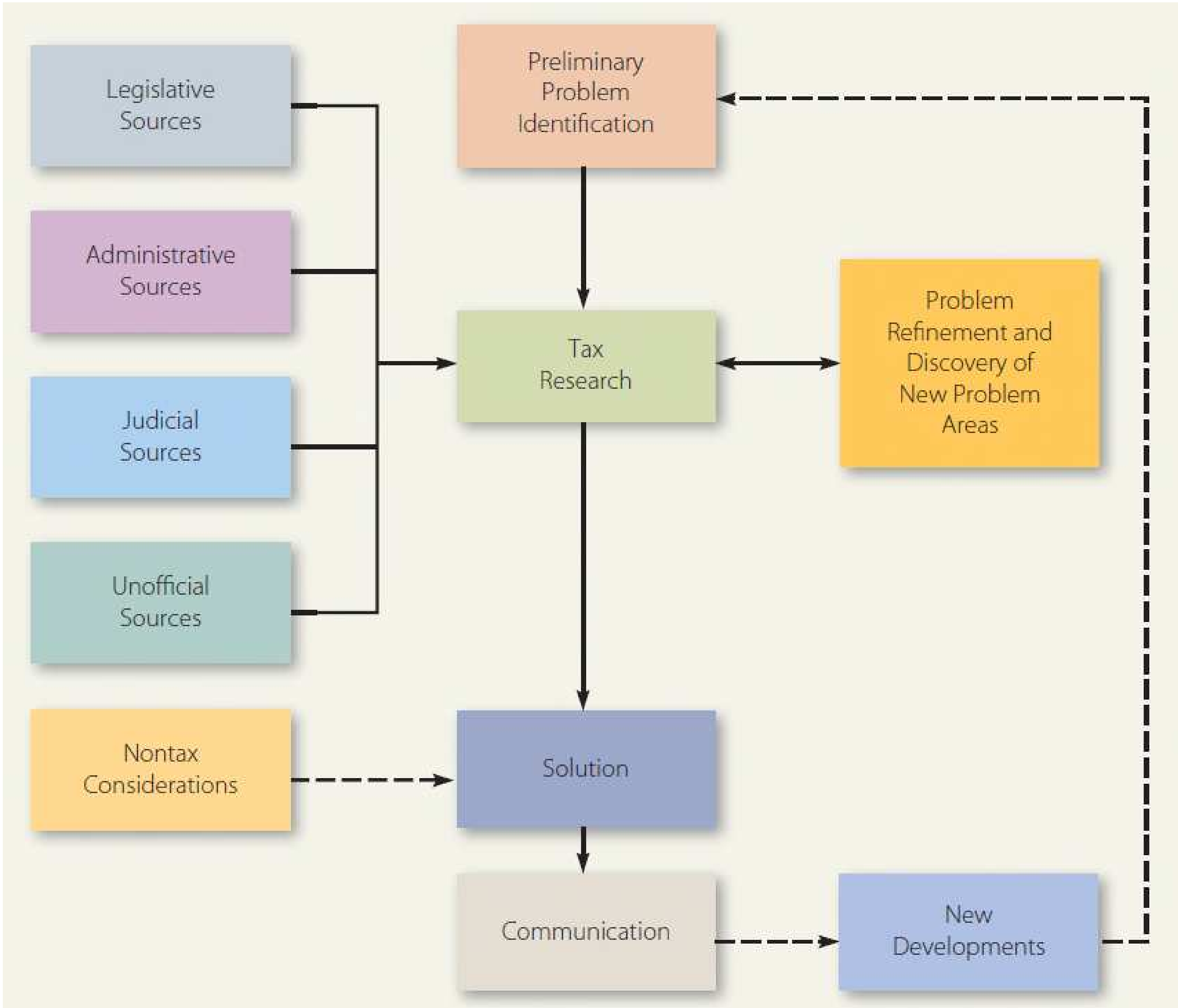
Tax Research Tools (slide 1 of 2)

- A crucial part of the research process is the ability to locate appropriate sources of the tax law
  - Both electronic and paper-based research tools are available to aid in this search
- Unless the problem is simple (e.g., the Code Section is known or there is a Regulation on point), the research process should begin with a tax service

Tax Research Tools (slide 2 of 2)

- Here is a partial list of the available commercial tax services:
  - *Standard Federal Tax Reporter*, Commerce Clearing House
  - *CCH IntelliConnect*, Commerce Clearing House online service
  - *United States Tax Reporter*, Research Institute of America
  - *Thomson Reuters Checkpoint*, Research Institute of America
  - *Tax Management Portfolios*, Bloomberg BNA
  - *Mertens Law of Federal Income Taxation*, Thomson Reuters
  - *Westlaw*, Thomson Reuters
  - *Tax Center*, LexisNexis

Tax Research Process



Tax Research

- Tax research is the method by which an interested party determines the best solution to a tax situation
- Tax research involves:
  - Identifying and refining the problem
  - Locating the appropriate tax law sources
  - Assessing the validity of the tax law sources
  - Arriving at the solution or at alternative solutions with due consideration given to nontax factors

Assessing The Validity Of Tax Law Sources (slide 1 of 4)

- Regulations
  - IRS agents must give the Code and the Regulations equal weight when dealing with taxpayers and their representatives
  - Proposed Regulations are not binding on IRS or taxpayer
  - Burden of proof is on taxpayer to show that a Regulation incorrect
  - If the taxpayer loses the challenge, a 20% negligence penalty may be imposed

Assessing The Validity Of Tax Law Sources (slide 2 of 4)

- Final Regulations tend to be of three types
  - Procedural: “Housekeeping-type” instructions
  - Interpretive: Rephrase what is in Committee Reports and the Code
    - Hard to get overturned
  - Legislative: Allow the Treasury Department to determine the details of law
    - Congress has delegated its legislative powers and these cannot generally be overturned

Assessing The Validity Of Tax Law Sources (slide 3 of 4)

- Revenue Rulings
  - Carry less weight than Regulations
  - Not substantial authority in court disputes

Assessing The Validity Of Tax Law Sources (slide 4 of 4)

- Judicial Sources
  - Consider the level of the court and the legal residence of the taxpayer
  - Tax Court Regular decisions carry more weight than Memo decisions
    - Tax Court does not consider Memo decisions to be binding precedents
    - Tax Court reviewed decisions carry even more weight
  - Circuit Court decisions where certiorari has been requested and denied by the U.S. Supreme Court carry more weight than a Circuit Court decision that was not appealed
  - Consider whether the decision has been overturned on appeal

Tax Law Sources (slide 1 of 2)

- Primary sources of tax law include:
  - The Constitution
  - Legislative history materials
  - Statutes (e.g., the Internal Revenue Code)
  - Treaties
  - Treasury Regulations
  - IRS pronouncements
  - Judicial decisions
- In general, the IRS considers only primary sources to constitute substantial authority

Tax Law Sources (slide 2 of 2)

- Secondary Sources include:
  - Legal periodicals
  - Treatises
  - Legal opinions
  - General Counsel Memoranda, and
  - Written determinations
- In general, secondary sources are not authority

Tax Planning

- The primary purpose of effective tax planning is to maximize the taxpayer's after-tax wealth
  - Must consider the legitimate business goals of taxpayer
- A secondary objective of effective tax planning is to reduce, defer, or eliminate the tax
- Tax avoidance vs. tax evasion
  - Tax avoidance is the legal minimization of tax liabilities and one goal of tax planning
  - Tax evasion is the illegal minimization of tax liabilities
    - Suggests the use of subterfuge and fraud as a means to tax minimization
    - Can lead to fines and jail

Taxation on the CPA Examination

- Taxation is included in the 3-hour Regulation section
- The Regulation section is 60% Taxation and 40% Law & Professional Responsibilities (all areas other than Business Structure)
- Knowledge is tested using both multiple-choice questions and task-based simulations

If you have any comments or suggestions concerning this PowerPoint Presentation for South-Western Federal Taxation, please contact:

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