

***Personal Finance, 6e (Madura)***  
**Chapter 4 Using Tax Concepts for Planning**

4.1 Background on Taxes

1) Knowledge of tax laws can help you conserve your income.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) Knowledge of individual income taxes is crucial to sound financial planning.

Answer: TRUE

Diff: 1

Question Status: Previous edition

3) Taxpayers can have more than the minimum amount of required income tax withheld from each pay.

Answer: TRUE

Diff: 2

Question Status: Previous edition

4) Your gross wages are subject to FICA (Federal Insurance Contributions Act) taxes that fund the Social Security system and Medicare.

Answer: TRUE

Diff: 1

Question Status: Previous edition

5) There is no Social Security tax on income beyond a certain level.

Answer: TRUE

Diff: 2

Question Status: Previous edition

6) Medicare is a government health insurance program that covers people over age 55 and provides payments to health care providers in case of illness.

Answer: FALSE

Diff: 2

Question Status: Previous edition

7) Medicare taxes are 1.45% of your salary, regardless of the salary amount.

Answer: TRUE

Diff: 2

Question Status: Previous edition

8) Employers have an option of whether or not to match an employee's Social Security and Medicare taxes.

Answer: FALSE

Diff: 1

Question Status: Previous edition

9) Students and other taxpayers earning less than \$100,000 a year with no dependents are eligible to file the simplest tax return, which is the 1040E-Z.

Answer: TRUE

Diff: 2

Question Status: Previous edition

10) The Tax Relief Act of 2001 provided educational incentives to a broad range of taxpayers and reduced contribution limits to retirement plans.

Answer: FALSE

Diff: 2

Question Status: Previous edition

11) The knowledge of tax laws can help you

A) conserve your income.

B) enhance your investments.

C) protect the transfer of your wealth at your death.

D) All of the above.

Answer: D

Diff: 1

Question Status: Previous edition

12) A branch of the U.S. Treasury Department, called the \_\_\_\_\_, administers the federal tax system.

A) U.S. Department of Tax

B) Internal Revenue Service

C) U.S. Tax Authority

D) U.S. Department of Collection

Answer: B

Diff: 1

Question Status: Previous edition

13) FICA taxes include two components, which consist of

A) accident and disability insurance.

B) unemployment compensation and disability insurance.

C) Social Security and Medicare contributions.

D) old age and unemployment compensation.

Answer: C

Diff: 2

Question Status: Revised

14) Which of the following taxes is only paid on the first \$118,500 of your salary?

- A) Federal Income Tax
- B) Social Security Tax
- C) Medicare Tax
- D) All of the above.

Answer: B

Diff: 2

Question Status: Revised

15) In 2015, self-employed individuals paid FICA taxes at a rate of

- A) 1.45 percent.
- B) 7.65 percent.
- C) 13.3 percent.
- D) 15.3 percent.

Answer: D

Diff: 2

Question Status: Revised

16) If you have a salary of \$30,000, an IRA deduction of \$2,000, a standard deduction of \$6,300, and a FICA rate of 7.65 percent, how much did you pay in FICA this year?

- A) \$1,805
- B) \$1,958
- C) \$2,142
- D) \$2,295

Answer: D

Diff: 2

Question Status: Revised

17) Which of the following statements is **not** true regarding FICA taxes paid?

- A) These taxes fund both Social Security and Medicare.
- B) Employers are required to match employee FICA contributions.
- C) All FICA taxes apply to your total income.
- D) There is a limit on how much of your income will be taxed for Social Security.

Answer: C

Diff: 2

Question Status: Previous edition

18) The Tax Relief Act of 2001

- A) raised the tax rates for the highest income portion of the population.
- B) limits further the ability to contribute to retirement plans tax-free.
- C) provided educational incentives to most taxpayers.
- D) reduced the child care credit available to most young families.

Answer: C

Diff: 2

Question Status: Previous edition

19) Determining taxes requires you to address all of the following topics **except**

- A) gross income.
- B) daily living expenses.
- C) deductions.
- D) exemptions.

Answer: B

Diff: 1

Question Status: Previous edition

20) Which tax form is generally used by taxpayers whose filing status is married, has no dependents, and whose taxable income is less than \$100,000?

- A) 1040
- B) 1040 A
- C) 1040 EZ
- D) 1040 X

Answer: A

Diff: 1

Question Status: Previous edition

21) \_\_\_\_\_ is withheld at a rate of 6.2% on the first \$118,500 of your 2015 earnings.

Answer: Social Security

Diff: 1

Question Status: Revised

22) Under the Affordable Care Act of 2010, if an individual does not have medical insurance coverage in 2016, they will

- A) still not have to pay 100% of their medical expenses if they cannot afford them.
- B) be subject to a tax penalty of up to 2.5% of income or \$695 per adult.
- C) only have to pay 75% of billed medical expenses.
- D) be subject to a \$250 fine.

Answer: B

Diff: 2

Question Status: New

23) Lucky Louie's base salary is \$90,000 per year and he earns an additional \$75,000 in annual bonus. Luckily, Lucky only has to pay FICA on

- A) his base salary.
- B) his base salary plus bonus up to the annual legal withholding limit for FICA.
- C) all of his earnings.
- D) \$130,000.

Answer: B

Diff: 2

Question Status: New

24) If you are working part time while going to school and have no dependents other than yourself, do not itemize deductions and have no capital asset transactions, which Federal Income Tax return form should you file?

A) 1040EZ

B) 1120

C) 1040X

D) Since you are part time and make just a few thousand dollars, you do not need to file an income tax return.

Answer: A

Diff: 2

Question Status: New

#### 4.2 Filing Status

1) Different tax rates are associated with each filing status such as single, married filing jointly, and head of household.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) All taxpayers have a large degree of freedom in choosing their filing status.

Answer: FALSE

Diff: 2

Question Status: Previous edition

3) Which of the following is **not** a tax filing status option?

A) Single

B) Divorced

C) Married filing jointly

D) Head of household

Answer: B

Diff: 1

Question Status: Previous edition

4) To qualify for "head of household" you must

A) be single.

B) have at least one dependent in your household.

C) be a homeowner.

D) Both A and B are correct.

Answer: D

Diff: 2

Question Status: Previous edition

5) If you are a surviving spouse, you may continue to use the married filing jointly tax rates unless

- A) you are divorced and your ex-spouse died in the last five years.
- B) your spouse died in the last two years.
- C) you have children you can claim as an exemption.
- D) you pay more than half the cost of maintaining your residence.

Answer: A

Diff: 2

Question Status: Previous edition

6) If you are a married taxpayer, you may use the \_\_\_\_\_ filing status.

- A) single
- B) married filing jointly or married filing separately
- C) head of household
- D) Any of the above may be used.

Answer: B

Diff: 1

Question Status: Previous edition

7) Jerry is divorced and has two children that live with him. What filing status should Jerry claim on his tax return?

- A) Single
- B) Head of household
- C) Married filing separately
- D) Married filing jointly

Answer: B

Diff: 1

Question Status: Previous edition

8) Michael's brother, Thomas, lives with Michael in his own home. Thomas has a full-time job and pays his brother for rent and utilities. Michael's filing status is

- A) single.
- B) head of household.
- C) married, filing separately.
- D) a qualifying widow(er).

Answer: A

Diff: 1

Question Status: Previous edition

9) Stephanie, who was divorced in 2015, had filed a joint tax return with her husband in 2014. During 2015, she did not remarry and continued to maintain her home in which her three dependent children lived. In preparation of her 2015 tax return, Stephanie should file as

- A) single.
- B) head of household.
- C) married filing separately.
- D) qualifying widow(er).

Answer: B

Diff: 1

Question Status: Revised

10) Assume you are still single and have no children, but your two siblings live with you in your home, you should file as

- A) single.
- B) head of household with two dependents.
- C) single with two dependents.
- D) single filing separately.

Answer: A

Diff: 1

Question Status: New

11) If you are married with two children and your two elderly parents live with you in an "in-law" suite, but pay a nominal rent monthly, you should file as

- A) married filing separately.
- B) married filing jointly with 4 total personal exemptions.
- C) married filing jointly with 6 total personal exemptions.
- D) married filing jointly with parents.

Answer: B

Diff: 2

Question Status: New

#### 4.3 Gross Income

1) Gross income consists of all reportable income from any source.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) All interest and dividends received by an individual taxpayer are taxable.

Answer: FALSE

Diff: 2

Question Status: Previous edition

3) The timing on the sale of an investment asset earning a capital gain makes little or no difference in the amount of taxes that are owed.

Answer: FALSE

Diff: 1

Question Status: Previous edition

4) A long-term capital gain results from profit on the sale of capital assets that were held 12 months or more.

Answer: TRUE

Diff: 1

Question Status: Previous edition

5) Employee contributions to qualified Individual Retirement Accounts (IRAs) and interest paid on student loans are adjusted from gross income to calculate a taxpayer's adjusted gross income.

Answer: TRUE

Diff: 2

Question Status: Previous edition

6) All reportable income from any source is called

A) wages and salaries.

B) gross income.

C) interest income.

D) dividend income.

Answer: B

Diff: 2

Question Status: Previous edition

7) Gross income includes all of the following **except**

A) salary or wages.

B) interest or dividends received.

C) employer's current contribution to 401(k).

D) capital gains realized.

Answer: C

Diff: 3

Question Status: Previous edition

8) Which of the following gross income is **not** taxable income?

A) Health insurance reimbursements

B) Interest income

C) Dividends

D) Tips received

Answer: A

Diff: 2

Question Status: Previous edition



9) Which of the following is **not** taxable for income tax purposes?

- A) Interest income
- B) Income from a rental property
- C) Child support
- D) Dividend income from selling stock

Answer: C

Diff: 2

Question Status: Previous edition

10) All of the following are types of nontaxable income **except**

- A) child support payments.
- B) casualty insurance reimbursements.
- C) rental income.
- D) reimbursements of moving expenses by an employer.

Answer: C

Diff: 1

Question Status: Previous edition

11) Which of the following is **not** subject to immediate taxation?

- A) A Christmas bonus
- B) Tips from your waitressing job
- C) Salary and wages
- D) Contributions to your employer-sponsored retirement account

Answer: D

Diff: 1

Question Status: Previous edition

12) Interest income would come from earnings on

- A) stocks.
- B) savings accounts.
- C) capital gains on investments.
- D) sale of mutual funds.

Answer: B

Diff: 1

Question Status: Previous edition

13) Income earned from the sale of an asset for more than you paid for it is classified as a(n)

- A) dividend income.
- B) interest income.
- C) capital gain.
- D) windfall.

Answer: C

Diff: 1

Question Status: Previous edition

14) If you were to receive \$100,000 from a corporation, the most tax-efficient way to receive it would be as

- A) dividends.
- B) interest.
- C) capital gains.
- D) salary.

Answer: C

Diff: 3

Question Status: Previous edition

15) If a stock was purchased in January 2014 for \$1,000 and sold in December 2015 for \$3,000, a \_\_\_\_\_ of \$2,000 results.

- A) long-term capital gain
- B) short-term capital gain
- C) long-term capital loss
- D) short-term capital loss

Answer: A

Diff: 2

Question Status: Revised

16) If a stock was purchased for \$5,000 in January 2015 and is sold in December 2015 for \$3,000, a \_\_\_\_\_ of \$2,000 results.

- A) long-term capital gain
- B) short-term capital gain
- C) long-term capital loss
- D) short-term capital loss

Answer: D

Diff: 2

Question Status: Revised

17) Jane purchased General Motors stock seven years ago for \$20,000. In 2015, she sold the stock for \$35,000. What is Jane's gain or loss?

- A) \$15,000 long-term gain
- B) \$15,000 short-term gain
- C) \$15,000 extraordinary gain
- D) No gain or loss is recognized

Answer: A

Diff: 2

Question Status: Revised

18) If you own stock that has increased in price, it would be best to sell it after you have owned it for at least

- A) 6 months and one day.
- B) 12 months and one day.
- C) 18 months and one day.
- D) 24 months and one day.

Answer: B

Diff: 2

Question Status: Previous edition

19) Gross income and adjusted gross income can be the same if you do not have any special adjustments. Which of the following is **not** one of these special adjustments?

- A) Capital gains are deducted and capital losses are added.
- B) IRA contributions are subtracted from gross income.
- C) Interest and dividend income is part of the income calculation.
- D) Alimony payments are deducted from gross income.

Answer: A

Diff: 3

Question Status: Previous edition

20) Jake invested \$800 in an IRA. If he has a 15% marginal tax rate and the contribution is tax deductible, Jake will

- A) pay \$120 more in taxes.
- B) pay \$120 less in taxes.
- C) receive no change to his tax liability.
- D) have \$800 more in adjusted gross income.

Answer: B

Diff: 1

Question Status: Previous edition

21) For qualified individuals, a contribution to a traditional IRA (Individual Retirement Account) is a(n)

- A) credit.
- B) adjustment to gross income.
- C) itemized expense.
- D) additional exemption amount.

Answer: B

Diff: 2

Question Status: Previous edition

22) Reductions of gross income for such items as individual retirement accounts (IRAs), moving expenses, and student loan interest payments will result in

- A) adjusted gross income.
- B) taxable income.
- C) earned income.
- D) passive income.

Answer: A

Diff: 1

Question Status: Previous edition

23) \_\_\_\_\_ and \_\_\_\_\_ are both reported on a Schedule B.

Answer: Interest income; dividend income

Diff: 1

Question Status: Previous edition

24) If you sell an asset that you owned for less than 12 months for more than you paid for it, you will report a(n) \_\_\_\_\_.

Answer: short-term capital gain

Diff: 1

Question Status: Previous edition

**Use the following two columns of items to answer the matching questions below:**

- A) interest earned from savings and debt securities
- B) forms used to report interest and deductions
- C) reportable income from any source
- D) earnings from stocks
- E) selling an asset for more than it cost

25) gross income

Diff: 1

Question Status: New

26) interest income

Diff: 1

Question Status: New

27) dividend

Diff: 1

Question Status: New

28) capital gains

Diff: 1

Question Status: New

29) tax return

Diff: 1

Question Status: New

Answers: 25) C 26) A 27) D 28) E 29) B

30) Which of the following is not includable in gross income for Federal income tax purposes?

- A) Sales commissions
- B) Cash you receive for painting your neighbor's house
- C) Qualifying dividends
- D) Municipal bond interest

Answer: D

Diff: 2

Question Status: New

31) Lucky Louie earned \$100,000 salary this year, had total itemized deductions of \$10,000, one personal exemption equal to \$4,000 and interest income of \$3,000. Louie, was not so lucky in the stock market however and had capital losses of \$8,000. What was Lucky Louie's taxable income?

- A) \$86,000
- B) \$81,000
- C) \$89,000
- D) \$90,000

Answer: A

Diff: 3

Question Status: New

#### 4.4 Deductions and Exemptions

1) All taxpayers have a choice of whether to take the standard deduction or itemize deductions.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) All medical expenses may be deducted from income as long as you have the receipts or can show proof of payment.

Answer: FALSE

Diff: 2

Question Status: Previous edition

3) A young couple buying a home would usually be better off to take the standard deduction rather than itemizing deductions.

Answer: FALSE

Diff: 2

Question Status: Previous edition

4) Interest expense paid on home loans and car loans is deductible from your income tax.

Answer: FALSE

Diff: 2

Question Status: Previous edition

5) Itemized deductions can include mortgage interest expense, state income tax expense, charitable contributions, and other employee expenses.

Answer: TRUE

Diff: 2

Question Status: Previous edition

6) A personal exemption can be claimed for the person filing a tax return, for a spouse, and for each dependent.

Answer: TRUE

Diff: 1

Question Status: Previous edition

7) The government usually adjusts the exemptions and standard deductions amounts annually to account for inflation.

Answer: TRUE

Diff: 1

Question Status: Previous edition

8) The standard deduction (assuming you are not over 65 or blind) is largest for

A) single filers.

B) head of household filers.

C) married filing jointly.

D) married filing separately.

Answer: C

Diff: 3

Question Status: Previous edition

9) The standard deduction is smallest for

A) single filers, assuming under age 65.

B) head of household filers, assuming over age 65 or blind.

C) married filing separately, assuming over age 65 or blind.

D) married filing jointly, assuming under age 65.

Answer: A

Diff: 3

Question Status: Previous edition

10) The filing status that yields the largest standard deduction per taxpayer is

A) married, filing jointly.

B) head of household.

C) single individual.

D) married, filing separately.

Answer: B

Diff: 3

Question Status: Previous edition

11) Which of the following is **not** a legitimate itemized deduction?

A) Mortgage interest expense

B) Real estate tax

C) Interest paid on credit cards

D) State income tax

Answer: C

Diff: 2

Question Status: Previous edition

12) \_\_\_\_\_ are specific expenses instead of a standard amount that reduce adjusted gross income.

- A) Exemptions
- B) Household expenses
- C) Itemized deductions
- D) Tax credits

Answer: C

Diff: 2

Question Status: Previous edition

13) An expense that could be included in the itemized deductions of a taxpayer is

- A) life insurance premiums.
- B) real estate property taxes.
- C) travel to work expenses.
- D) driver license fees.

Answer: B

Diff: 1

Question Status: Previous edition

14) Which of the following conditions will **not** afford you a tax advantage?

- A) Being over age 65
- B) Being deaf
- C) Being widowed within the past two years
- D) Being blind

Answer: B

Diff: 1

Question Status: Previous edition

15) Purchasing which of the following items on credit will help reduce your tax bill?

- A) Automobile
- B) Home
- C) Stereo
- D) Boat

Answer: B

Diff: 1

Question Status: Previous edition

16) Which item below **cannot** be taken as an itemized deduction?

- A) Medical expenses
- B) Charitable contributions
- C) Child and dependent care expenses
- D) Real estate taxes

Answer: C

Diff: 1

Question Status: Previous edition



- 17) You should claim itemized deductions if
- A) itemized deductions exceed the standard deduction.
  - B) the standard deduction exceeds itemized deductions.
  - C) itemized deductions exceed exemptions.
  - D) itemized deductions exceed tax credits.

Answer: A

Diff: 1

Question Status: Previous edition

- 18) When you own a house as a primary residence,
- A) it is always best to itemize deductions on your tax return.
  - B) your property taxes are not deductible.
  - C) you get a straight \$5,000 deduction.
  - D) interest and taxes may increase your allowable deductions to the point where it is beneficial to itemize them.

Answer: D

Diff: 2

Question Status: Previous edition

- 19) Which of the following can be deducted from your taxable income even if you do not itemize?

- A) Mortgage interest expense
- B) Real estate taxes
- C) State income taxes
- D) Student loan interest

Answer: D

Diff: 2

Question Status: Revised

- 20) A allowable amount which taxpayers can claim for themselves and dependents is called a(n)

- A) allowance.
- B) deduction.
- C) exemption.
- D) exclusion.

Answer: C

Diff: 1

Question Status: Previous edition

21) Jerry is divorced and has two children that live with him. In addition he baby-sits three other children in the evenings and has a cat and two dogs. How many exemptions can he claim on his tax return?

- A) One
- B) Two
- C) Three
- D) Four

Answer: C

Diff: 2

Question Status: Previous edition

22) Lynn and Robert are married and support Lynn's father who has no income, and Robert's mother, who has no income. If Lynn and Robert file a joint return, how many exemptions may they claim?

- A) 2
- B) 3
- C) 4
- D) 5

Answer: C

Diff: 2

Question Status: Previous edition

23) George is 65 years old. He supports his father who is 90 years old, blind, and has no income. How many exemptions should George claim on his tax return?

- A) 1
- B) 2
- C) 3
- D) 4

Answer: B

Diff: 2

Question Status: Previous edition

24) Taxpayers who are blind get the benefit of

- A) an additional exemption.
- B) an additional amount added to their standard deduction.
- C) an additional amount added to their itemized deduction.
- D) not having to file a tax return because they are blind.

Answer: A

Diff: 2

Question Status: Revised

- 25) When taxable income exceeds certain levels, the itemized deductions and exemptions
- A) are reduced.
  - B) are limited but may be carried over to future years.
  - C) reach a maximum allowable amount.
  - D) increase in proportion to increases in taxable income.

Answer: A

Diff: 3

Question Status: Previous edition

- 26) Legal methods of reducing your taxes include all of the following **except**
- A) organizing your records to track appropriate expenses and contributions.
  - B) preparing your return early in the year so you are not rushed.
  - C) seeking the advice of an accountant.
  - D) overstating cash contributions to Salvation Army Christmas kettles.

Answer: D

Diff: 1

Question Status: Previous edition

- 27) The \_\_\_\_\_ is a fixed amount deducted from adjusted gross income to determine taxable income.

Answer: standard deduction or personal exemption

Diff: 1

Question Status: Revised

- 28) In order to claim a tax deduction for a charitable contribution, you must be
- A) over 21 years of age.
  - B) earning more than \$50,000 per year.
  - C) itemizing deductions on your income tax return.
  - D) in at least the 25% tax bracket.

Answer: C

Diff: 1

Question Status: New

#### 4.5 Taxable Income and Taxes

- 1) Only the income that remains after deductions and exemptions are subtracted from adjusted gross income is taxable.

Answer: TRUE

Diff: 2

Question Status: Previous edition

- 2) Under the Tax Relief Act of 2003, the lowest tax bracket for single taxpayers earning \$8,000 or less is 15 percent.

Answer: FALSE

Diff: 1

Question Status: Previous edition

3) Tax credits amount to the same savings as tax deductions.

Answer: FALSE

Diff: 2

Question Status: Previous edition

4) A dollar's worth of tax credits is more valuable than a dollar's worth of deductions.

Answer: TRUE

Diff: 2

Question Status: Previous edition

5) An earned income credit is a special credit that reduces the amount of taxes owed by taxpayers who earn high incomes.

Answer: FALSE

Diff: 3

Question Status: Previous edition

6) In 2001, the tax laws were changed to allow substantial tax benefits for parents who wish to set aside money for their children's future college expenses.

Answer: TRUE

Diff: 2

Question Status: Previous edition

7) Which of the following is the correct method for starting with gross income and computing taxable income?

A) Subtract the standard deduction and exemptions

B) Add the itemized deductions and subtract the exemptions

C) Subtract IRA contributions and add exemptions

D) Subtract adjustments, deductions, and exemptions

Answer: D

Diff: 2

Question Status: Previous edition

8) The tax method that uses the principle of taxing those more who earn more is called \_\_\_\_\_ taxation.

A) benefits received

B) payment burden

C) progressive

D) regressive

Answer: C

Diff: 1

Question Status: Previous edition

9) The highest tax rate a taxpayer is charged on his or her federal tax return is called the \_\_\_\_\_ rate.

- A) marginal
- B) average
- C) maximum
- D) true

Answer: A

Diff: 2

Question Status: Previous edition

10) Which of the following items is **not** impacted by the taxpayer's income level?

- A) Amount withheld for Social Security
- B) Amount withheld for Medicare taxes
- C) College expense credits
- D) Personal exemptions

Answer: D

Diff: 2

Question Status: Previous edition

11) Which of the following is **not** a tax credit mentioned in the chapter?

- A) Child tax credit
- B) Second income credit
- C) College expense credit
- D) Earned income credit

Answer: B

Diff: 2

Question Status: Previous edition

12) Which of the following is **not** an acceptable method of reducing your tax bill?

- A) Have a mortgage on your home with tax deductible interest
- B) Increase your contributions to tax-advantage retirement accounts
- C) Invest in municipal bonds
- D) Have your paycheck deposited directly to an off-shore bank

Answer: D

Diff: 2

Question Status: Previous edition

13) Melanie, a homeowner, has mortgage interest of \$3,000, real estate taxes of \$1,500, and charitable contributions of \$500. According to her filing status, a standard deduction of \$6,300 is allowed. How much should Melanie deduct on her tax return?

- A) \$5,000
- B) \$6,300
- C) \$6,700
- D) \$7,700

Answer: B

Explanation: B) Itemized deductions =  $\$3,000 + \$1,500 + \$500 = \$5,000$  which is less than the standard deduction of \$5,950, so she should deduct \$5,950.

Diff: 1

Question Status: Revised

14) Christopher is a single college student and earns \$13,000 from a part-time job. He has taxable interest income of \$1,400 and itemized deductions of \$690. Calculate Christopher's taxable income for 2015 assuming his parents do not claim him as a dependent on their tax return.

- A) \$4,100
- B) \$4,000
- C) \$10,510
- D) \$12,310

Answer: A

Explanation: A)

Adjusted Gross Income:	\$14,400 ( $\$13,000 + \$1,400$ )
Standard Deduction	\$5,950
Personal Exemption	<u>\$3,800</u>
Taxable Income	\$4,650

Diff: 2

Question Status: Revised

15) Sally's adjusted gross income is \$38,000. She does not own a home, but has charitable contributions of \$1,500 and interest on her car loan of \$2,100. This year she also had medical expenses of \$2,000. She is allowed a standard deduction of \$6300 and one personal exemption of \$4,000. What is Sally's taxable income?

- A) \$38,000
- B) \$31,300
- C) \$27,700
- D) \$29,200

Answer: C

Explanation: C)

Adjusted gross income	\$38,000
Standard deduction	\$5,950 (exceeds itemized deductions of \$1,500)
Minus personal exemption	<u>\$3,800</u>
Taxable income	\$28,250

Diff: 2

Question Status: Revised

16) Erin has a tax credit of \$100 and a marginal tax rate of 28 percent. Erin's income tax liability will be reduced by how much as a result of the credit?

- A) \$100
- B) \$128
- C) \$28
- D) \$2,800

Answer: A

Explanation: A) Tax credits are a dollar-for-dollar reduction in determining tax liability.

Diff: 1

Question Status: Previous edition

*For solving the questions below, the individual tax rates in Exhibit 4.6 must be made available to the students.*

17) Enrico and his wife have combined salaries of \$85,000. They have interest and dividends on their investments of \$1,000 and annually contribute a combined \$3,000 to a traditional IRA. The interest on their home mortgage is \$2,500, they contributed \$1,000 to their church, and incurred medical expenses not covered by insurance of \$1,800. Assuming they can claim two personal exemptions of \$4,000 each and file joint tax returns, compute their tax liability for 2015.

- A) \$11,606
- B) \$10,056
- C) \$9,981
- D) \$8,287

Answer: D

Explanation: D)

Salary	\$85,000
Interest and dividends	<u>\$1,000</u>
Gross income	\$86,000
Less IRA contributions	<u>\$3,000</u>
AGI	\$83,000
Less standard deduction	\$11,900 (greater than itemized deductions of \$3,500)
Less exemptions (2)	<u>\$7,600</u>
Taxable income	\$63,500

Exhibit 4.6, panel B -  $\$1,740 + 15\%(\$63,500 - \$17,400) = \$8,655$

Diff: 1

Question Status: Revised

18) Ralph and Josee have adjusted gross income of \$53,000. They have itemized deductions of \$18,000 and incurred \$2,000 in college expenses for their daughter who is a freshman at a local community college. They file jointly and have three exemptions at \$4,000 each. Compute their tax liability for the current year.

- A) \$227
- B) \$1,170
- C) \$255
- D) \$2,780

Answer: A

Explanation: A)

AGI	\$53,000
Less itemized deductions	\$18,000
Less exemptions (3)	<u>\$11,400</u>
Taxable income	\$23,600

Exhibit 4.6, Panel B -  $\$1,740 + 15\%(\$23,600 - \$17,400) = \$2,670 - \$2,000$  (college expense credit) = \$670

Diff: 1

Question Status: Revised

19) List your income, deductions, adjusted gross income, number of exemptions at \$3,000 each, and itemized deductions or a standard deduction of \$5,000 to arrive at taxable income. If you would like, make up an example if you don't want to supply your own figures. Justify the number of exemptions.

Answer: Income less deductions gives adjusted gross income. Exemptions and itemized deductions or the standard deduction are subtracted from adjusted gross income to arrive at taxable income.

Diff: 1

Question Status: Previous edition

20) A(n) \_\_\_\_\_ offsets taxes by subtracting the full amount from the taxes owed.

Answer: tax credit

Diff: 1

Question Status: Previous edition



**Use the following two columns of items to answer the matching questions below:**

- A) annual minimum amount set per filing status
- B) tax imposed on real property
- C) amount deducted for each person on the tax return
- D) tax imposed by the state on income
- E) a dollar for dollar deduction from taxes

21) standard deduction

Diff: 1

Question Status: New

22) real estate tax

Diff: 1

Question Status: New

23) state income tax

Diff: 1

Question Status: New

24) exemption

Diff: 1

Question Status: New

25) tax credits

Diff: 1

Question Status: New

Answers: 21) A 22) B 23) D 24) C 25) E

26) Qualifying dividends, interest and capital gains on assets held more than one year are taxed at what rate for most taxpayers?

A) 15%

B) 28%

C) a blend of 15% and 28%

D) These three categories of income are not taxed at the same rates.

Answer: D

Diff: 3

Question Status: New

#### 4.6 How Tax Planning Fits Within Your Financial Plan

1) The key tax planning decisions in building your financial plan are knowing what tax savings are currently available to you and how you can increase your tax savings in the future.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) Describe how taxes affect your personal budget, income statement, and balance sheet.

Answer: This is a subjective question. Taxes reduce wealth or income. However, some deductions are allowed for expenses such as home mortgage interest and real estate taxes that the government uses to encourage certain activities. Tax planning helps minimize taxes through retirement planning and purchases.

Diff: 1

Question Status: Previous edition

3) Comment on your level of knowledge to prepare your taxes. Do you need to hire a CPA or can you prepare them? Are you going to invest in any software that helps you prepare your return?

Answer: You have the basic knowledge to prepare your tax return. An expert is not necessary unless you have a complicated return. There are many software packages available at a reasonable cost that can help you prepare your taxes.

Diff: 1

Question Status: Previous edition

4) Comment on a large tax refund. Is it a good use of your funds considering present value concepts? Does the government pay you interest? What can you do to change your withholding or recalculate it?

Answer: A large refund is not a prudent use of funds since the government does not pay you interest. A form W-4 is an aid for calculating withholding and for changing it.

Diff: 1

Question Status: Previous edition

5) If you are paying taxes at the 35% tax bracket, you should

A) consider investing in tax free municipal bonds.

B) make the maximum tax deductible contribution to your company 401K.

C) increase the interest expenses you pay by taking loans on expensive autos instead of paying cash.

D) Both A and B are correct.

Answer: D

Diff: 2

Question Status: New

- 6) Prudent tax planning considers ways to
- A) reduce your taxes by not recognizing some of your income.
  - B) reduce income by deferring recognition via 401k and IRA accounts.
  - C) maximize long term capital gains.
  - D) Both B and C are correct.

Answer: D

Diff: 2

Question Status: New