## Solution to Problem Materials

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*The solution to this problem is available on a transparency master.*
CHECK FIGURES

27. $175,000.
28. $120,009.
29. $12,000.
30.a. $79,200.
30.b. $20,160.
31. $32,850.
32.a. $51,000.
32.b. $17,000.
33. $27,285
34. 2003 $6,420; 2014 $2,137.
35.a. $23,640.
35.b. $38,178.
36.a. $44,441.
36.b. $45,441.
36.c. Allocate to furniture.
37. Deduction $10,000; carryforward $11,000.
38. Cost recovery $14,000; § 179 carryforward $17,000.
39.a. $14,266.
39.b. $38,016.
39.c. $8,313.
40. Deduction $13,400; carryforward $16,600.
41. $27,200.
42. $1,200.
44. $33,800.
46. $474.
47. $640.
48. Deduction $1,755; inclusion amount $36.40.
49. Leasing provides a greater benefit.
50. $3,682.
51. Regular tax deduction $2,400; AMT deduction $1,800.
52.a. $85,740.
52.b. $64,260.
53. $2,052.
54. $0.
55. The first option produces a $12,617 greater deduction.
56. $1,000,000.
57. Capitalized $1,880,000; expensed $1,024,000.
58. AGI without purchase $30,320; AGI with purchase $35,500.
59. Refund due for 2002 $1,615.
DISCUSSION QUESTIONS

1. Real property (except land) is subject to cost recovery if the real property is used in a trade or business or held for the production of income. If the real property is held for personal use, it is not eligible for cost recovery deductions. pp. 7-2 and 7-3

2. The basis of the property must be reduced by the amount of cost recovery that should have been deducted (i.e., the cost recovery “allowable”). p. 7-4

3. Land is not eligible for cost recovery. However, improvements to the land such as landscaping are eligible for cost recovery. pp. 7-5 and 7-11

4. The relevant issues for Henry are:
   • Can a portion of the purchase costs of a ski resort, which are allocated to the construction costs of the resort’s mountain roads, trails, and slopes, be depreciated?
   • If such costs can be depreciated, what is the correct recovery period?
   • Can costs incurred subsequent to the purchase, attributable to maintenance of such mountain roads, trails, and slopes, be depreciated?
   pp. 7-5 and 7-11

5. The relevant issues for Pale are:
   • What property qualifies for cost recovery?
   • Is the property used in Pale’s trade or business?
   • What is the cost recovery period for the property?
   pp. 7-5 and 7-11

6. The half-year convention must be used for all MACRS personalty except when the mid-quarter convention applies. The mid-quarter convention must be used when more than 40% of the value of property, other than real property, is placed in service during the last quarter of the tax year. pp. 7-7 and 7-8

7. The asset is treated as if it were sold in the middle of the year, and hence, one-half year of cost recovery is allowed for the year of the sale. p. 7-7 and Concept Summary 7-2

8. The 30% additional first-year depreciation is computed first and then the standard cost recovery allowance under MACRS is calculated by multiplying the cost recovery basis (original cost recovery basis less 30% additional first-year depreciation) by the applicable MACRS percentage. p. 7-7

9. The asset is treated as if it was sold in the middle of the month, and hence, one-half month of cost recovery is allowed for the month of the sale. pp. 7-9, 7-10, and Concept Summary 7-2
10. The relevant tax issues for Jed are:
   - Whether the costs associated with the tin added to the original “bath” mixture may be deducted as business expenses or must be capitalized.
   - If the costs must be capitalized, what is the period of their cost recovery?
   - Whether the costs associated with the additional tin added to the “bath” mixture may be deducted as business expenses or must be capitalized.

pp. 7-1 to 7-9

11. The MACRS straight-line election may be made on a portion of the assets, but it must apply to all assets in a particular class. pp. 7-11 and 7-12

12. Even if MACRS straight-line is elected, personal property is still subject to the mid-quarter convention if more than 40% of the value of property, other than real property, is placed in service during the last quarter of the tax year. p. 7-12 and Concept Summary 7-3

13. An asset used in connection with an individual’s personal investments would not be an asset used in a trade or business. Therefore, the asset would not qualify for the § 179 expensing election. Neither investment property nor personal use property is eligible for the § 179 expensing election. Investment property is eligible for cost recovery, however. pp. 7-5 and 7-12

14. The basis of the asset is reduced by the § 179 limited expensing deduction (after applying the $200,000 limitation and before the taxable income limitation) before computing the 30% additional first-year depreciation. pp. 7-12 and 7-13

15. The § 179 amount eligible for expensing in a carryforward year is limited to the lesser of (1) the statutory dollar amount ($24,000 in 2002 and $25,000 in 2003) reduced by the cost of § 179 property placed in service in excess of $200,000 in the carryforward year or (2) the business income limitation in the carryforward year. p. 7-14

16. Taxable income, for § 179 purposes, is defined as the aggregate amount of taxable income of any trade or business of the taxpayer without regard to the amount expensed under § 179. Therefore, the taxable income computation for purposes of the § 179 limit includes the deductions for the 30% additional first-year depreciation and regular MACRS. pp. 7-13 and 7-14

17. An automobile is listed property and consequently must pass the predominantly business use test to be eligible for MACRS statutory percentage cost recovery. However, by weighing more than 6,000 pounds, the automobile is not subject to the statutory dollar limits on cost recovery. pp. 7-15 and 7-16

18. The statutory limit has been increased by $4,600 for the first year to take into account the 30% additional first-year depreciation. p. 7-16

19. The following issues are relevant for Sarah:
   - Are the limousines listed property?
   - Are the limousines passenger automobiles?
• What amount of cost recovery may be taken?
• Do the limousines qualify for the § 179 expensing election?

pp. 7-15 to 7-18

20. The purpose of the lease inclusion amount is to prevent taxpayers from circumventing the cost recovery dollar limitations by leasing instead of purchasing an automobile. The dollar amount is taken from an IRS table and is prorated for the number of days of the lease term included in the taxable year. This amount is then adjusted to reflect the business and income producing use of the automobile. pp. 7-18 and 7-19

21. The amortization period for a § 197 intangible is 15 years regardless of the actual useful life. p. 7-21

22. Self-created goodwill is not eligible for amortization. For goodwill to qualify for amortization, it must be purchased. p. 7-21

23. The following issues are relevant for Wendy:
• Does the goodwill qualify for amortization under § 197?
• If the goodwill can be amortized, what amount of the goodwill will be subject to amortization?

p. 7-21

24. Intangible drilling and development costs can either be written off as an expense in the year in which they are incurred or capitalized and written off through depletion. p. 7-22

25. To calculate cost depletion, the adjusted basis of the asset (e.g., mineral interest) is divided by the estimated recoverable units of the asset to arrive at the depletion per unit. The depletion per unit is then multiplied by the number of units sold in that particular year to arrive at the deduction for depletion (assuming the percentage depletion amount is not larger). pp. 7-22 and 7-23

PROBLEMS

26. Cost of asset $100,000
   Less: Greater of allowed and allowable cost recovery:
   2001 $ 455
   2002 3,636
   Basis at the end of 2002 $ 95,909
   Less: Cost recovery for 2003 ($100,000 X 3.636% X .5/12) (152)
   Basis on date of sale $ 95,757
   Gain on sale of asset ($98,000 – $95,757) $  2,243

pp. 7-4, 7-10 and Table 7-9

27. José’s basis for cost recovery is $175,000 because the fair market value of the house at the date of the conversion from personal use to rental property ($210,000) is greater than the $175,000 adjusted basis. p. 7-4
28. 30% additional first-year depreciation ($300,000 X 30%) $ 90,000
Standard MACRS [($300,000 – $90,000) X 14.29% (Table 7-1)] 30,009
Total cost recovery $120,009

The property is 7-year property. Exhibit 7-1

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

29. Improvements to land have a 15-year cost recovery period. Therefore, the cost recovery is $12,000, computed as follows:

$240,000 X 5% (Table 7-1) = $12,000

Exhibit 7-1

30. a. 2003
30% additional first-year depreciation ($180,000 X 30%) $54,000
Standard MACRS [($180,000 – $54,000) X 20% (Table 7-1)] 25,200
Total cost recovery $79,200

b. 2004
Standard MACRS [$126,000 X 32% (Table 7-1) X 1/2] $20,160

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

31. The mid-quarter convention must be used because the cost of the computers acquired in the 4th quarter exceeds 40% of the cost of all the personal property acquired during the year ($120,000/$280,000 = 43%).

Furniture (7-year class) [$100,000 X 17.85% (Table 7-2)] $17,850
Trucks (5-year class) [$60,000 X 15% (Table 7-2)] 9,000
Computers (5-year class) [$120,000 X 5% (Table 7-2)] 6,000
Total cost recovery $32,850

32. a. 1985: $850,000 X 6% (Table 7-6) $51,000
b. 2003: $850,000 X 2% (Table 7-6) X 4.5/12 $17,000

33. The building does not meet the 80% gross receipts from dwelling units test. Therefore, it is classified as nonresidential real property. The building’s depreciable basis is
$1,500,000 [($2,000,000 \text{ (cost)} – $500,000 \text{ (land)})].

\[ \text{\$1,500,000} \times 1.819\% \text{ (Table 7-9)} = \text{\$27,285} \]

p. 7-10

34. 2003: $2,000,000 \times 0.321\% \text{ (Table 7-9)} = \text{\$6,420}

2014: $2,000,000 \times 2.564\% \text{ (Table 7-9)} \times 0.5/12 = \text{\$2,137}

pp. 7-9 and 7-10

35. The building’s depreciable basis is $1,200,000 [($1,400,000 \text{ (cost)} – $200,000 \text{ (land)})].

a. 2003: $1,200,000 \times 0.0197 \text{ (Table 7-9)} = \text{\$23,640}

b. 2009: $1,200,000 \times 0.03636 \text{ (Table 7-9)} \times 10.5/12 = \text{\$38,178}

pp. 7-10 and 7-11

36. a. Immediate expense deduction under § 179 $25,000

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\begin{align*}
\text{Additional first-year depreciation} \, [(\$31,000 \,- \,$25,000) \times 30\%] & = 1,800 \\
\text{Regular MACRS} \, [(\$31,000 \,- \,$25,000 \,- \,$1,800) \times 20\%] & = 840 \\
\text{Furniture} & \\
\text{Additional first-year depreciation} \, ($42,000 \times 30\%) & = 12,600 \\
\text{Regular MACRS} \, [(\$42,000 \,- \,$12,600) \times 14.29\%] & = 4,201 \\
\text{Total deduction} & = \text{\$44,441}
\end{align*}

b. Immediate expense deduction under § 179 $25,000

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\begin{align*}
\text{Additional first-year depreciation} \, ($31,000 \times 30\%) & = 9,300 \\
\text{Regular MACRS} \, ($31,000 \,- \,$9,300) \times 20\% & = 4,340 \\
\text{Furniture} & \\
\text{Additional first-year depreciation} \, ($42,000 \,- \,$25,000) \times 30\% & = 5,100 \\
\text{Regular MACRS} \, ($42,000 \,- \,$25,000 \,- \,$5,100) \times 14.29\% & = 1,701 \\
\text{Total deduction} & = \text{\$45,441}
\end{align*}

c. The deduction for the year would be $1,000 ($45,441 – $44,441) larger if the § 179 expense is allocated to the furniture (i.e., the longer lived asset).

Note: The 30\% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

pp. 7-5 to 7-13 and Table 7-1

37. § 179 deduction before adjustments $25,000

Less: Dollar limitation reduction ($208,000 – $200,000) (8,000)

§ 179 potential deduction $17,000

Business income limitation $10,000
§ 179 deduction allowed $10,000

§ 179 deduction carryforward from 2002 ($4,000) and 2003 ($7,000) $11,000

The carryforward is subject to the effect of the $200,000 ceiling and the business income limitation in the carryforward year.

pp. 7-13 and 7-14

38. Cost recovery for furniture
   Additional first-year depreciation [($40,000 – $25,000) X 30%] $ 4,500
   Regular MACRS [($40,000 – $25,000 – $4,500) X 14.29%] 1,500

Income limitation
   Income before § 179 and cost recovery $100,000
   Cost recovery ($86,000 + $4,500 + $1,500) (92,000)
   Income before § 179 amount $ 8,000

Section 179 amount of $25,000 but limited to $8,000 8,000
Total deduction with respect to the furniture in 2003 $14,000

Section 179 carryforward to 2004 ($25,000 – $8,000) $17,000

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

pp. 7-13, 7-14, Exhibit 7-1, and Table 7-1

39. a. Yoon must use the mid-quarter convention.
   3-year class ($20,000 X 58.33%) $11,666
   5-year class ($52,000 X 5%) 2,600
   Total cost recovery $14,266

b. Section 179 amount on 5-year class property $25,000
   3-year class ($20,000 X 58.33%) 11,666
   5-year class [($52,000 – $25,000) X 5%] 1,350
   Total deduction $38,016

c. Section 179 election—total deduction $38,016
   No § 179 election—total deduction (14,266)
   Increase in deduction from § 179 election $23,750

   Tax benefit (.35 X $23,750) $ 8,313

pp. 7-5 to 7-8, 7-12, 7-13, and Table 7-2
Depreciation, Cost Recovery, Amortization, and Depletion

40. Net income before cost recovery and § 179 deduction $20,000
Additional first-year depreciation [(40,000 – 25,000) X 30%] (4,500)
Regular MACRS [(40,000 – 25,000 – 4,500) X 20%] (2,100)
§179 income limit $13,400

§ 179 potential deduction ($5,000 + $25,000) $30,000
§ 179 deduction for 2003 (13,400)
§ 179 carryforward $16,600

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

pp. 7-13, 7-14, and Table 7-1

41. Willis, Hoffman, Maloney, and Raabe, CPAs
5191 Natorp Boulevard
Mason, OH 45040

December 20, 2002

Mr. John Johnson
100 Morningside Drive
Clinton, MS 39058

Dear Mr. Johnson:

I am responding to your inquiry concerning the amount of cost recovery you may deduct in the first year of operation of a new taxi. If the automobile is purchased at the beginning of 2003 for $30,000, the total cost recovery deductions in the first year would be $27,200.

Because the car will be used as a taxi, it is not subject to the cost recovery limitations imposed on passenger automobiles. This $27,200 cost recovery assumes that your income from your taxi business before considering this cost recovery would be at least $25,000 and an election is made under § 179 to expense the maximum allowable amount. The $27,200 is calculated as follows:

§ 179 amount $25,000
Additional first-year depreciation [(30,000 – 25,000) X 30%] 1,500
Regular MACRS [(30,000 – 25,000 – 1,500) X 20%] 700
Total deduction $27,200

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

If you need additional information or need clarification of our calculations, please contact me.

Sincerely yours,
TAX FILE MEMORANDUM

December 20, 2002

FROM: John J. Jones

SUBJECT: John Johnson: Calculations for cost recovery in year of acquisition

Facts. John Johnson is considering purchasing an automobile at the beginning of 2003 to be used 100% as a taxi. The cost of the automobile is $30,000. John wants to know the total cost recovery deductions for the year of acquisition of the car.

Calculations. Because the automobile will be used as a taxi, it is not subject to the cost recovery limitations for passenger automobiles. Therefore, John can elect § 179 expensing. In deducting the full § 179 amount of $25,000, the assumption is made that John’s income from the taxi business before considering the § 179 expense will equal or exceed $25,000. The total amount of cost recovery in the acquisition year would be $27,200, computed as follows:

- § 179 amount $25,000
- Additional first-year depreciation \[\left(\$30,000 - \$25,000\right) \times 30\%\] $1,500
- Regular MACRS \[\left(\$30,000 - \$25,000 - \$1,500\right) \times 20\%\] $700
- Total deduction $27,200

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

pp. 7-12 to 7-16 and Table 7-1

42. Cost $30,000
   Statutory percentage (mid-quarter convention) \(\times 5\%\) 
   Cost recovery but subject to the limitation $1,500
   Recovery limit (limited to $3,060*) $1,500
   Less: Personal usage (20% \(\times \$1,500\)) (300)
   Cost recovery $1,200

*These cost recovery limits are indexed annually. The 2002 amounts are used because the 2003 amounts were not available yet.

pp. 7-15 to 7-17 and Table 7-2

43. Deduction for 2003
   \[\left(\$18,000 \times 30\%\right) + \left[\left(\$18,000 - \$5,400\right) \times 20\%\right] = \$7,920\] limited to $7,660* $7,660

Deduction for 2004
   \[\left(\$18,000 - \$5,400\right) \times 32\%\] $4,032
Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

*These cost recovery limits are indexed annually. The 2002 amounts are used because the 2003 amounts were not available yet.

pp. 7-15 to 7-18 and Table 7-1

44. Because the Ford Excursion has a GVW rating in excess of 6,000 pounds, it is not a passenger automobile and hence is not subject to the cost recovery limitations.

\[
\begin{align*}
\text{§ 179 limited expensing deduction} & = \$25,000 \\
\text{Additional first-year depreciation} & = [($45,000 \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text{ } \text {...
Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

pp. 7-15 to 7-17

47. Because the computer is not used in a trade or business, Abdel may not elect § 179 expensing. The computer is listed property which does not satisfy the predominant business usage test. Therefore, Abdel must use straight-line cost recovery for the computer and the 30% additional first-year depreciation cannot be taken.

\[ \$8,000 \times 10\% \times 80\% \text{ production of income usage (Table 7-3)} = \$640 \]

pp. 7-15 to 7-18

48. Deduction for lease payments:

\[ \$450 \times 6 \text{ months} \times 65\% = \$1,755 \]

Inclusion amount:

\[ \$112 \times 1/2 \times 65\% = \$36.40 \]

Example 28

49. Willis, Hoffman, Maloney, and Raabe, CPAs
   5191 Natorp Boulevard
   Mason, OH 45040

December 20, 2002

Mr. Dennis Harding
150 Avenue I
Memphis, TN 38112

Dear Mr. Harding:

I am writing in response to your request concerning the tax consequences of purchasing versus leasing an automobile. Our calculations are based on the data you provided in our telephone conversation.

If the automobile is purchased, the total cost recovery deductions for the five years would be $19,060. If the automobile is leased, lease payment deductions would total $21,000. In addition, you also would have to include $1,049 in your gross income.

If you need additional information or need clarification of our calculations, please contact us.

Sincerely yours,

John J. Jones, CPA
Partner
TAX FILE MEMORANDUM

December 20, 2002

FROM: John J. Jones

SUBJECT: Dennis Harding: Calculation of lease versus purchase

Facts. Dennis Harding is considering purchasing or leasing an automobile on January 1, 2003. The purchase price of the automobile is $30,500. The lease payments for five years would be $350 per month. The inclusion dollar amounts for the next five years would be $71, $155, $230, $275, and $318. Dennis wants to know the effect on his adjusted gross income for the purchase versus the lease of the automobile for five years.

Calculations

Purchase: cost recovery deductions

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost Recovery Deduction</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>$13,420 (limited to $7,660)</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>$4,900 (limited to $4,900)</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>$2,950 (limited to $2,950)</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>$1,775 (limited to $1,775)</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>$1,775 (limited to $1,775)</td>
<td></td>
</tr>
</tbody>
</table>

Total cost recovery deductions: $19,060

*These cost recovery limits are indexed annually. The 2002 amounts are used because the 2003 amounts were not available yet.

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

Lease:

Lease payments ($350 X 60) $21,000

Inclusion dollar amounts ($71 + $155 + $230 + $275 + $318) $1,049

50. $70,000 X 5.26% = $3,682

51. For regular income tax liability

$12,000 X 20% = $2,400

For AMT liability

$12,000 X 15% = $1,800
52. a. Cost 
   Rate (7-year class, Table 7-1) 
   Cost recovery 
   $600,000
   X 14.29%
   $ 85,740

   b. Cost 
   Rate (7-year class, Table 7-4) 
   Cost recovery 
   $600,000
   X 10.71%
   $ 64,260

   pp. 7-5 to 7-7, 7-19 to 7-21, and Exhibit 7-1

53. MACRS:
   Year 1 [$60,000 X 14.29% (Table 7-1)] $ 8,574
   Year 2 ($60,000 X 24.49%) 14,694
   Year 3 ($60,000 X 17.49%) 10,494
   Total cost recovery $33,762

   ADS:
   Year 1 [$60,000 X 10.71% (Table 7-4)] $ 6,426
   Year 2 ($60,000 X 19.13%) 11,478
   Year 3 ($60,000 X 15.03%) 9,018
   Total cost recovery (26,922)

   Cost recovery lost by electing ADS $ 6,840

   Tax cost of election ($6,840 X 30%) $ 2,052

   pp. 7-5 to 7-7 and 7-19 to 7-21

54. $0. Self-created goodwill is not a § 197 intangible and therefore cannot be amortized. p. 7-21

55. Willis, Hoffman, Maloney, and Raabe, CPAs
    5191 Natorp Boulevard
    Mason, OH 45040

October 15, 2003

Mr. Mike Saxon
200 Rolling Hills Drive
Shavertown, PA 18708

Dear Mr. Saxon:

This letter is in response to your request concerning the tax consequences of allocating the purchase price of a business between the two assets purchased: a warehouse and goodwill.

If the purchase price of $2,000,000 is allocated $1,200,000 to the warehouse and $800,000 to goodwill, the total recovery in the first year of operations would be $82,865. Cost recovery on the warehouse would be $29,532 and amortization of the goodwill would be $53,333. If the purchase price is allocated $1,500,000 to the warehouse and $500,000 to goodwill, the total recovery in the first year of operations would be $70,248. Cost recovery on the warehouse would be $36,915 and amortization of the goodwill would be $33,333.
Therefore, under the first option, your deductions in the first year would be $12,617 greater ($82,865 – $70,248). The building is written off over 39 years, while the goodwill is written off over 15 years. Thus, the higher the allocation to goodwill, the faster the write-off will be. Should you need more information or clarification of calculations, please contact us.

Sincerely yours,

John J. Jones, CPA
Partner

TAX FILE MEMORANDUM

October 15, 2003

FROM: John J. Jones
SUBJECT: Mike Saxon: Calculations of amount of recovery depending on the allocation of purchase price between a warehouse and goodwill

Facts. Mike is negotiating the purchase of a business. The final purchase price ($2 million) has been determined, but the allocation of the purchase price between a warehouse and goodwill is still subject to discussion. Two alternatives are being considered. The first alternative would allocate $1,200,000 to the warehouse and $800,000 to goodwill. The second alternative would allocate $1,500,000 to the warehouse and $500,000 to goodwill. Mike wants to know the total recovery during the first year of operations from the two alternatives.

Calculations

Alternative 1
Warehouse [$1,200,000 X 2.461% (Table 7-9)] $29,532
Goodwill ($800,000/15 years) 53,333
Total recovery $82,865

Alternative 2
Warehouse [$1,500,000 X 2.461% (Table 7-9)] $36,915
Goodwill ($500,000/15 years) 33,333
Total recovery $70,248

Additional deductions in first year under alternative 1 ($82,865 – $70,248) $12,617

56. Gross income $6,000,000
Less: Expenses (4,000,000)
Taxable income before depletion $2,000,000
Cost depletion ($5,000,000/250,000 X 45,000) = $900,000
Percentage depletion (22% X $6,000,000 = $1,320,000, limited to 50% X $2,000,000 = $1,000,000) (1,000,000)
Taxable income $1,000,000
Not expensed

Gross income $3,840,000
Less: Expenses (1,240,000)
Taxable income before depletion $2,600,000
Cost depletion ($6* X 120,000) $720,000
Percentage depletion (15% X $3,840,000) $576,000
Greater of cost or percentage depletion (720,000)
Taxable income $1,880,000

Expensed

Gross income $3,840,000
Less: Expenses, including IDC (2,240,000)
Taxable income before depletion $1,600,000
Cost depletion ($4** X 120,000) $480,000
Percentage depletion (15% X $3,840,000) $576,000
Greater of cost or percentage depletion (576,000)
Taxable income $1,024,000

*Oil interest cost plus IDC ($2,000,000 plus $1,000,000) ÷ 500,000 equals $6.

**Oil interest cost of $2,000,000 ÷ 500,000 equals $4.

CUMULATIVE PROBLEMS

58. Willis, Hoffman, Maloney, and Raabe, CPAs
    5191 Natorp Boulevard
    Mason, OH 45040

December 21, 2003

Mr. John Smith
1045 Center Street
Lindon, UT 84059

Dear Mr. Smith:

I am writing in response to your request concerning the effects on your 2003 adjusted gross income of selling IBM stock and using some of the proceeds to purchase an automobile to be used in your business.

If the stock is not sold and the car is not purchased, your adjusted gross income would be $30,320. If the stock is sold and the car purchased, your adjusted gross income would be $35,500. The supporting calculations follow:
No sale of stock and no purchase of car

Fees for services $266,000
Less: Business expenses

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building rental</td>
<td>$36,000</td>
</tr>
<tr>
<td>Office furniture and equipment rental</td>
<td>5,000</td>
</tr>
<tr>
<td>Office supplies</td>
<td>2,500</td>
</tr>
<tr>
<td>Utilities</td>
<td>4,000</td>
</tr>
<tr>
<td>Salaries ($35,000 + $42,000)</td>
<td>77,000</td>
</tr>
<tr>
<td>Payroll taxes</td>
<td>9,000</td>
</tr>
<tr>
<td>Fuel and oil</td>
<td>21,000</td>
</tr>
<tr>
<td>Cost recovery (Note 3):</td>
<td></td>
</tr>
<tr>
<td>Front end loaders</td>
<td>73,040</td>
</tr>
<tr>
<td>Dump truck</td>
<td>13,640</td>
</tr>
</tbody>
</table>

Total business expenses (241,180)

Business income before § 179 deduction $24,820
Less: § 179 deduction (Note 1) (14,000)

Business income $10,820
Interest income 10,000
Dividend income 9,500
Adjusted gross income $30,320

Notes

(1) Less § 179 deduction of $14,000 [$25,000 (normal limit) – $11,000 (reduction in limit $211,000 – $200,000)].

(2) The inheritance from Aunt Mildred is excludible under § 101.

(3) Cost recovery

Front end loader
Additional first-year depreciation ($180,000 – $14,000) (Note 1) X 30% $49,800
Regular MACRS ($180,000 – $14,000 – $49,800) X 20% 23,240
Total cost recovery $73,040

Dump truck
Additional first-year depreciation ($31,000 X 30%) $9,300
Regular MACRS ($31,000 – $9,300) X 20% 4,340
Total cost recovery $13,640

Sale of stock and purchase of car

Fees for services $266,000
Less: Business expenses

<table>
<thead>
<tr>
<th>Category</th>
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</tr>
<tr>
<td>Utilities</td>
<td>4,000</td>
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<tr>
<td>Salaries ($35,000 + $42,000)</td>
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</tr>
<tr>
<td>Fuel and oil</td>
<td>21,000</td>
</tr>
<tr>
<td>Cost recovery (Note 3):</td>
<td></td>
</tr>
</tbody>
</table>
Front end loaders  79,200
Dump truck  13,640
Car  7,660

Total business expenses (255,000)
Business income before § 179 deduction $ 11,000
Less: § 179 deduction (Note 1) (-0-)
Business income 11,000
Interest income 10,000
Dividend income 9,500
Gain on stock sale (Note 2) 5,000
Adjusted gross income $ 35,500

Notes

(1) There would be no § 179 deduction because the normal limit of $25,000 would be reduced by $86,000 ($286,000 – $200,000), but not below zero.

(2) The inheritance from Aunt Mildred is excludible under § 101. John’s recognized gain on the sale of the IBM stock is $5,000 ($115,000 amount realized – $110,000 adjusted basis) and is classified as a long-term capital gain.

(3) Cost recovery

Front end loader
Additional first-year depreciation ($180,000 X 30%) $54,000
Regular MACRS ($180,000 – $54,000) X 20% 25,200
Total cost recovery $79,200

Dump truck
Additional first-year depreciation ($31,000 X 30%) $ 9,300
Regular MACRS ($31,000 – $9,300) X 20% 4,340
Total cost recovery $13,640

Car
($75,000 X 30%) + [($75,000 – $22,500) X 20%] (limited to $7,660)* $ 7,660
Total cost recovery $ 7,660

*The cost recovery limits are indexed annually. The 2002 amounts are used because the 2003 amounts were not available yet.

Should you need more information or need for us to clarify our calculations, please contact us.

Sincerely,

John J. Jones, CPA
Partner
TAX FILE MEMORANDUM

December 20, 2003

FROM: John J. Jones

SUBJECT: John Smith: Calculation of adjusted gross income for (1) no sale of stock or purchase of car versus (2) sale of stock and purchase of car

Facts. John is considering selling inherited IBM stock with an adjusted basis to him of $110,000 for $115,000 on December 29, 2003. He would use $75,000 of the proceeds to purchase a car that would be used 100% for business. John wants to know the effect these transactions would have on his adjusted gross income.

No sale of stock and no purchase of car

Fees for services $266,000
Less: Business expenses
   Building rental $36,000
   Office furniture and equipment rental 5,000
   Office supplies 2,500
   Utilities 4,000
   Salaries ($35,000 + $42,000) 77,000
   Payroll taxes 9,000
   Fuel and oil 21,000
   Cost recovery (Note 3):
     Front end loaders 73,040
     Dump truck 13,640
Total business expenses (241,180)
Business income before § 179 deduction $ 24,820
Less: § 179 deduction (Note 1) (14,000)
Business income $ 10,820
Interest income 10,000
Dividend income 9,500
Adjusted gross income $ 30,320

Notes
(1) Less § 179 deduction of $14,000 [$25,000 (normal limit) – $11,000 (reduction in limit $211,000 – $200,000)]

(2) The inheritance from Aunt Mildred is excludible under § 101.

(3) Cost recovery

   Front end loader
     Additional first-year depreciation ($180,000 – $14,000) X 30% (Note 1) $49,800
     Regular MACRS ($180,000 – $14,000 – $49,800) X 20% 23,240
     Total cost recovery $73,040

   Dump truck
     Additional first-year depreciation ($31,000 X 30%) $ 9,300
     Regular MACRS ($31,000 – $9,300) X 20% 4,340
     Total cost recovery $13,640
Sale of stock and purchase of car

Fees for services $266,000
Less: Business expenses
  Building rental $36,000
  Office furniture and equipment rental 5,000
  Office supplies 2,500
  Utilities 4,000
  Salaries ($35,000 + $42,000) 77,000
  Payroll taxes 9,000
  Fuel and oil 21,000
  Cost recovery (Note 3):
    Front end loaders 79,200
    Dump truck 13,640
    Car 7,660
Total business expenses (255,000)
Business income before § 179 deduction $ 11,000
Less: § 179 deduction (Note 1) (-0-)
Business income $ 11,000
Interest income 10,000
Dividend income 9,500
Gain on stock sale (Note 2) 5,000
Adjusted gross income $ 35,500

Notes

(1) There would be no § 179 deduction because the normal limit of $25,000 would be reduced by $78,000 ($278,000 – $200,000), but not below zero.

(2) The inheritance from Aunt Mildred is excludible under § 101. John’s recognized gain on the sale of the IBM stock is $5,000 ($115,000 amount realized – $110,000 adjusted basis) and is classified as a long-term capital gain.

(3) Cost recovery

Front end loader
  Additional first-year depreciation ($180,000 X 30%) $54,000
  Regular MACRS ($180,000 – $54,000) X 20% 25,200
  Total cost recovery $79,200

Dump truck
  Additional first-year depreciation ($31,000 X 30%) $ 9,300
  Regular MACRS ($31,000 – $9,300) X 20% 4,340
  Total cost recovery $13,640

Car
  ($75,000 X 30%) + [($75,000 – $22,500) X 20%] (limited to $7,660)*  $ 7,660
  Total cost recovery $ 7,660

*The cost recovery limits are indexed annually. The 2002 amounts are used because the 2003 amounts were not available yet.

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179
Depreciation, Cost Recovery, Amortization, and Depletion 7-23

Therefore, the solution for this problem has been prepared based on this premise.

59. Net income from Writers Anonymous (Note 1) $18,304
Interest income 4,000
Self-employment tax (Note 2) (1,293)
Adjusted gross income $21,011
Less: Itemized deductions (Note 3)
    Personal exemption (3,000)
Taxable income $  7,311
Tax on $7,311 from 2002 Tax Table $     799
Self-employment tax 2,586
Less: Estimated tax payments (5,000)
Net tax payable (or refund due) for 2002 ($  1,615)

Notes

(1) The net income of Writers Anonymous is calculated as follows:

    Income from sales $97,000
    Less: Rent $16,500
    Utilities 7,900
    Supplies 1,800
    Insurance 5,000
    Travel excluding meals ($3,500 – $1,200) 2,300
    Meals ($1,200 – $600) 600
    Property taxes on car (60%) 600
    Depreciation (Note 4) 43,996 (78,696)
    Net income $18,304

(2) The self-employment tax is calculated as follows:

    1. Net earnings from self-employment $18,304
    2. Multiply line 1 by 92.35% 16,904
    3. If the amount on line 2 is $84,900 or less,
       multiply the line 2 amount by 15.3%.
       This is the self-employment tax. $  2,586

    One half of the self-employment tax, or $1,293, is a deduction for AGI.

(3) The itemized deductions are as follows:

    State income tax $ 2,000
    Home mortgage interest 6,000
    Property taxes on home 1,100
    Property taxes on car (40%) 400
    Charitable contributions 1,200
    Total itemized deductions $10,700

(4) Furniture and fixtures:

    § 179 limited expensing $19,000
    Cost recovery ($19,000 – $19,000) -0- $19,000
Computer equipment:

§179 limited expensing $  5,000
Additional first-year depreciation
($40,000 – $5,000) X 30%  10,500
Regular MACRS
($40,000 – $5,000 – $10,500) X 20%  4,900  20,400
Automobile
{($37,000 X 30%) + [($37,000 – $11,100) X 20%]
(limited to $7,660)*} X 60%  4,596
Total deduction $43,996

*The cost recovery limits are indexed annually. The 2002 amounts are used because the 2003 amounts were not available yet.

Note: The 30% additional first-year depreciation under § 168(k) applies unless the taxpayer elects for it not to apply (i.e., like standard MACRS and unlike the § 179 election). Therefore, the solution for this problem has been prepared based on this premise.

The § 179 limited expensing election is made first associated with the furniture and fixtures ($19,000) and then for the computer equipment ($5,000) because the furniture and fixtures have a 7-year recovery period, whereas the computer equipment has a 5-year recovery period.

See the tax return solution beginning on page 7-24 of the Solutions Manual.
Depreciation, Cost Recovery, Amortization, and Depletion

Form 1040
U.S. Individual Income Tax Return 2002

Label
Last name
MCN

Use the IRS label. Otherwise, please print or type.

Home address (number and street) if you have a P.O. box, see instructions.
Pleasantville

City, town or post office. If you have a foreign address, see instructions.

State ZIP code

Importantly, you must enter your Social security number(s) above.

Presidential Election Campaign (See instructions.)

Note: Checking “I” will not change your tax or reduce your refund. Do you or your spouse filing a joint return, want $5 to go to this fund? 

Filing Status
1 Single
2 Married filing jointly (even if only one had income)
3 Married filing separately. Enter spouse’s SSN above & full name here

Exemptions
6a Yourself, if your parent (or someone else) can claim you as dependent on his or her return, do not check box 6a

Dependents:

(1) First name

(2) Dependent’s social security number

(3) Dependent’s relationship to you

(4) Year

(5) Dependents claimed (See instructions.)

Total number of exemptions claimed

Income

7 Wages, salaries, tips, etc. Attach Schedule W-2

8a Taxable interest. Attach Schedule B if required

8b Tax-exempt interest. Do not include on line 8a

9 Ordinary dividends. Attach Schedule B if required

10 Taxable refunds, credits, or offsets of state and local income taxes (See instructions)

11 Alimony received

12 Business income or (loss). Attach Schedule C or C-EZ

13 Capital gain (or loss). Attach Schedule D or Form 8949, if not filed, here

14 Other gains or (losses). Attach Form 4977

15a IRA distributions

15b Taxable amount (See instructions)

16a Pensions and annuities

16b Taxable amount (See instructions)

17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E

18 Farm income or (loss). Attach Schedule F

19 Unemployment compensation

20a Social security benefits

20b Taxable amount (See instructions)

21 Other income

22 Add the amounts in the right column for lines 7 through 21. This is your total income

Adjusted Gross Income

23 Educator expenses (see instructions)

24 IRA deduction (see instructions)

25 Student loan interest deduction (see instructions)

26 Tuition and fees deduction (see instructions)

27 Archer MSA deduction. Attach Form 8853

28 Moving expenses. Attach Form 3903

29 One-half of self-employment tax. Attach Schedule SE

30 Self-employed health insurance deduction (see instructions)

31 Self-employed SEP, SIMPLE, and qualified plans

32 Penalty on early withdrawal of savings

33a Alimony paid

33b Reimburse SSN

34 Add lines 23 through 33a

35 Subtract line 34 from line 22. This is your adjusted gross income

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see instructions.

Department of the Treasury — Internal Revenue Service
### Form 1040 (2002)

#### JANICE MORGAN

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount/Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>36</td>
<td>Amount from line 36 (adjusted gross income)</td>
<td>21,011</td>
</tr>
<tr>
<td>37a</td>
<td>Check if: □ You were 65 or older, □ Blind, □ Spouse was 65 or older, □ Blind</td>
<td></td>
</tr>
<tr>
<td>37b</td>
<td>Add the number of boxes checked above and enter the total here</td>
<td></td>
</tr>
<tr>
<td>38</td>
<td>Itemized deductions (from Schedule A or your standard deduction)</td>
<td>10,700</td>
</tr>
<tr>
<td>39</td>
<td>Subtract line 36 from line 38</td>
<td>10,311</td>
</tr>
<tr>
<td>40</td>
<td>If line 38 is $103,000 or less, multiply $5,000 by the total number of exemptions claimed on line 6a. If line 38 is over $103,000, see the worksheet in the instructions.</td>
<td>3,000</td>
</tr>
<tr>
<td>41</td>
<td>Taxable income. Subtract line 40 from line 29.</td>
<td>7,311</td>
</tr>
<tr>
<td>42</td>
<td>Tax (see instructions). Check if any taxes from: □ Form(s) 8914 □ Form(s) 4952</td>
<td>799</td>
</tr>
<tr>
<td>43</td>
<td>Alternative minimum tax (see instructions), Attach Form 6251</td>
<td></td>
</tr>
<tr>
<td>44</td>
<td>Add lines 42 and 43</td>
<td></td>
</tr>
<tr>
<td>45</td>
<td>Foreign tax credit. Attach Form 1116 if required</td>
<td></td>
</tr>
<tr>
<td>46</td>
<td>Credit for child and dependent care expenses, Attach Form 2441</td>
<td></td>
</tr>
<tr>
<td>47</td>
<td>Credit for the elderly or the disabled, Attach Schedule R</td>
<td></td>
</tr>
<tr>
<td>48</td>
<td>Education credits. Attach Form 8863</td>
<td></td>
</tr>
<tr>
<td>49</td>
<td>Retirement savings contributions credit. Attach Form 8949</td>
<td></td>
</tr>
<tr>
<td>50</td>
<td>Child tax credit (see instructions)</td>
<td></td>
</tr>
<tr>
<td>51</td>
<td>Adoption credit. Attach Form 8839</td>
<td></td>
</tr>
<tr>
<td>52</td>
<td>Credits from: □ Form(s) 8936 □ Form(s) 8859</td>
<td></td>
</tr>
<tr>
<td>53</td>
<td>Other credits. Check applicable boxes: □ Form(s) 3800 □ Form(s) 993 □ specify</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Add lines 45 through 53. These are your total credits</td>
<td>799</td>
</tr>
<tr>
<td>55</td>
<td>Subtract line 54 from line 44. If line 54 is more than line 44, enter 0.</td>
<td>2,586</td>
</tr>
<tr>
<td>56</td>
<td>Self-employment tax, Attach Schedule SE</td>
<td></td>
</tr>
<tr>
<td>57</td>
<td>Social security and medicare tax or tip income not reported to employer, Attach Form 4952</td>
<td></td>
</tr>
<tr>
<td>58</td>
<td>Tax on qualified plans, including IRAs, and other tax-favored accounts, Attach Form(s) 6911 if required</td>
<td></td>
</tr>
<tr>
<td>59</td>
<td>Advance earned income credit payments from Form(s) W-2</td>
<td></td>
</tr>
<tr>
<td>60</td>
<td>Household employment taxes. Attach Schedule H</td>
<td></td>
</tr>
<tr>
<td>61</td>
<td>Add lines 55-60. This is your total tax</td>
<td>3,385</td>
</tr>
<tr>
<td>62</td>
<td>Federal income tax withheld from Forms W-2 and 1099</td>
<td></td>
</tr>
<tr>
<td>63</td>
<td>2002 estimated tax payments and amounts applied from 2001 return</td>
<td>5,966</td>
</tr>
<tr>
<td>64</td>
<td>Earned income credit (EIC)</td>
<td></td>
</tr>
<tr>
<td>65</td>
<td>Excess social security and 10% FICA tax withheld (see instructions)</td>
<td></td>
</tr>
<tr>
<td>66</td>
<td>Additional child tax credit. Attach Form 8612</td>
<td></td>
</tr>
<tr>
<td>67</td>
<td>Amount paid with request for extension form(s) (see instructions)</td>
<td></td>
</tr>
<tr>
<td>68</td>
<td>Other items from: □ Form(s) 2439 □ Form(s) 4138 □ Form(s) 8866 □ specifie</td>
<td></td>
</tr>
<tr>
<td>69</td>
<td>Add lines 62 through 68. These are your total payments</td>
<td>5,000</td>
</tr>
<tr>
<td>70</td>
<td>Refund: If line 89 is more than line 81, subtract line 81 from line 89. This is the amount you overpaid</td>
<td>1,615</td>
</tr>
<tr>
<td>71a</td>
<td>Amount of line 70 you want refunded to you</td>
<td>1,615</td>
</tr>
<tr>
<td>71b</td>
<td>□ Routing number</td>
<td></td>
</tr>
<tr>
<td>71c</td>
<td>□ Type: □ Checking □ Savings</td>
<td></td>
</tr>
<tr>
<td>72</td>
<td>Amount of line 70 you want applied to your 2003 estimated tax</td>
<td>72</td>
</tr>
<tr>
<td>73</td>
<td>Amount you owe. Subtract line 80 from line 61. For details on how to pay, see instructions</td>
<td>72</td>
</tr>
<tr>
<td>74</td>
<td>Estimated tax penalty (see instructions)</td>
<td></td>
</tr>
</tbody>
</table>

### Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see instructions)?

- □ Yes. Complete the following.
- □ No

#### Sign Here

- Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and that 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: [Signature]
- Date: [Date]
- Your occupation: [Occupation]
- Daytime phone number: [Phone]
- Preparer's SSN or PTIN: [SSN]
- Preparer's phone number: [Phone]

- Your signature: [Signature]
- Date: [Date]
- Spouse's occupation: [Occupation]
- Daytime phone number: [Phone]

- Preparer's signature: [Signature]
- Date: [Date]
- Preparer's phone number: [Phone]

#### Paid Preparer's Signature

- Name: [Name]
- License number: [Number]
- Preparer's SSN or PTIN: [SSN]
- Preparer's phone number: [Phone]

#### Use Only

- Filing status: Single, Married filing separately, Head of household, Married filing jointly or qualifying widow/widower, Other (specify): [Status]
| SCHEDULE A |  |
| Form 1040 | Itemized Deductions | |
| | | OMB No. 1545-0074 |
| | | 2002 |
| | | Your social security number 189-57-6691 |

59. continued

<table>
<thead>
<tr>
<th>Caution. Do not include expenses reimbursed or paid by others.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Medical and dental expenses (see instructions) 1</td>
</tr>
<tr>
<td>2 Enter amount from Form 1040, line 36 2</td>
</tr>
<tr>
<td>3 Multiply line 2 by 7.5% (0.075) 3</td>
</tr>
<tr>
<td>4 Subtract line 3 from line 1. If line 3 is more than line 1, enter 0. 4</td>
</tr>
<tr>
<td>5 State and local income taxes 5 2,000</td>
</tr>
<tr>
<td>6 Real estate taxes (see instructions) 6 1,100</td>
</tr>
<tr>
<td>7 Personal property taxes 7 400</td>
</tr>
<tr>
<td>8 Other taxes, list type and amount 8</td>
</tr>
<tr>
<td>9 Add lines 5 through 8 9 3,500</td>
</tr>
<tr>
<td>10 Home mortgage interest paid to you on Form 1098 10 6,000</td>
</tr>
<tr>
<td>11 Home mortgage interest not reported to you on Form 1098 11</td>
</tr>
<tr>
<td>(See instructions)</td>
</tr>
<tr>
<td>12 Points not reported to you on Form 1098. See instructions for split rules 12</td>
</tr>
<tr>
<td>13 Investment interest, Attach Form 8283 if required 13</td>
</tr>
<tr>
<td>(See instructions)</td>
</tr>
<tr>
<td>14 Add lines 10 through 13 14 6,000</td>
</tr>
<tr>
<td>15 Gifts to Charity 15 1,200</td>
</tr>
<tr>
<td>16 Other than by cash or check. If any gift of $250 or more, see instructions 16</td>
</tr>
<tr>
<td>17 Carryover from prior year 17</td>
</tr>
<tr>
<td>18 Add lines 15 through 17 18 1,200</td>
</tr>
<tr>
<td>19 Casualty or theft loss(es). Attach Form 4684. (See instructions) 19</td>
</tr>
<tr>
<td>20 Unreimbursed employee expenses—job travel, union dues, job education, etc. You must attach Form 2106 or 2106-EZ 20</td>
</tr>
<tr>
<td>(See instructions for expenses to deduct here)</td>
</tr>
<tr>
<td>21 Tax preparation fees 21</td>
</tr>
<tr>
<td>22 Other expenses—investment, safe deposit box, etc. List type and amount 22</td>
</tr>
<tr>
<td>23 Add lines 20 through 22 23</td>
</tr>
<tr>
<td>24 Enter amount from Form 1040, line 36 24</td>
</tr>
<tr>
<td>25 Multiply line 24 by 2% (.02) 25</td>
</tr>
<tr>
<td>26 Subtract line 25 from line 24. If line 25 is more than line 24, enter 0 26</td>
</tr>
<tr>
<td>27 Other—From list in the instructions. List type and amount 27</td>
</tr>
<tr>
<td>28 See Form 1040, line 38, over $137,300 (over $188,850 if MFJ)?</td>
</tr>
</tbody>
</table>

No. Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter this amount on Form 1040, line 38. 28 10,700

Yes. Your deduction may be limited. See instructions for the amount to enter.

For Paperwork Reduction Act Notice, see Form 1040 instructions.
Schedule B – Interest and Ordinary Dividends

**Part I**

<table>
<thead>
<tr>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>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 the interest first. Also, show buyer’s social security number and address.</td>
</tr>
<tr>
<td>Amount</td>
</tr>
<tr>
<td>4,000.00</td>
</tr>
</tbody>
</table>

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

**Part II**

<table>
<thead>
<tr>
<th>Ordinary Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 Add the amounts on line 1.</td>
</tr>
<tr>
<td>3 Extractable interest on series EE and I U.S. savings bonds issued after 1989 from Form 8815, line 14. You must attach Form 8815.</td>
</tr>
<tr>
<td>4 Subtract line 3 from line 2. Enter the result here and on Form 1040, line 9a.</td>
</tr>
<tr>
<td>Amount</td>
</tr>
<tr>
<td>4,000.00</td>
</tr>
</tbody>
</table>

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

**Part III**

<table>
<thead>
<tr>
<th>Foreign Accounts and Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 List name of payer. Include only ordinary dividends. If you received any capital gain distributions, see the instructions for Form 1040, line 13.</td>
</tr>
<tr>
<td>Amount</td>
</tr>
<tr>
<td>6 Add the amounts on line 5. Enter the total here and on Form 1040, line 9a.</td>
</tr>
</tbody>
</table>

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

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

7 a At any time during 2002, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions for exceptions and filing requirements for Form TD F 90-22.1. |
| Yes | No |
| X | |

b If Yes, enter the name of the foreign country. |

8 During 2002, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? |
| Yes | No |
| X | |
### Depreciation, Cost Recovery, Amortization, and Depletion

**Schedule C** (Form 1040)  
**Profit or Loss from Business** (Sole Proprietorship)

<table>
<thead>
<tr>
<th>Name of proprietor</th>
<th>Social security number (SSN)</th>
</tr>
</thead>
<tbody>
<tr>
<td>JANICE MORGAN</td>
<td>189-57-6691</td>
</tr>
</tbody>
</table>

**Writers Anonymous**  
2751 WADDHAM ROAD   
PLEASANTVILLE, NM 77196

**F Accounting method:**  
(1) Cash (2) Accrual (3) Other (specify)  
**G Did you “materially participate” in the operation of this business during 2002?” If No, see instructions for limit on losses.**  
Yes [ ] No [x]

### Part I: Income

1. **Gross receipts or sales.** **Caution:** If this income was reported to you on Form W-2 and the **statutory employee** box on that form was checked, see the instructions and check here.  
2. **Returns and allowances:**  
3. **Subtract line 2 from line 1:**  
4. **Cost of goods sold (from line 4 on page 2):**  
5. **Gross profit. Subtract line 4 from line 3:**  
6. **Other income, including Federal and state gasoline or fuel tax credit or refund:**

### Part II: Expenses. Enter expenses for business use of your home only on line 30.

| Expenses |  
|----------|-------------------------------------------------|
| Advertising |  
| Bad debts from sales or services |  
| Car and truck expenses |  
| Commissions and fees |  
| Depreciation |  
| Deduction and section 179 expense deduction (not included in Part III) |  
| Employee benefit programs (other than on line 19) |  
| Insurance (other than health) |  
| Interest |  
| Legal or professional services |  
| Office expense |  

### Part III: Total expenses. Subtract line 28 from line 27 in columns.  
29. **Tentative profit (loss).** Subtract line 28 from line 7.  
30. **Expenses for business use of your home.** Attach Form 8829.

### Schedule C (Form 1040) 2002
59. continued

Who Must File Schedule SE

You must file Schedule SE if:

- You had net earnings from self-employment from other than church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of $400 or more.
- You had church employee income of $108.29 or more. Income from services you performed as a minister or as a member of a religious order is not church employee income. See instructions.

Note: Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use the "optional method" in Part II of Long Schedule SE. See instructions.

Exception: If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner and you filed Form 1040 and received IRS approval not to be taxed on those earnings, do not file Schedule SE. Instead, write "Exempt - Form 1040, line 55." to Schedule SE (Form 1040) 2002

May I Use Short Schedule SE or Must I Use Long Schedule SE?

<table>
<thead>
<tr>
<th>Did You Receive Wages or Tips In 2002?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>No</strong></td>
</tr>
<tr>
<td>Are you a minister, member of a religious order, or Christian Science practitioner who received IRS approval not to be taxed on earnings from these sources, but you owe self-employment tax on other earnings?</td>
</tr>
<tr>
<td><strong>No</strong></td>
</tr>
<tr>
<td>Did you receive church employee income reported on Form W-2 of $108.29 or more?</td>
</tr>
<tr>
<td><strong>No</strong></td>
</tr>
</tbody>
</table>

You May Use Short Schedule SE Below

You Must Use Long Schedule SE

Section A - Short Schedule SE

1. Net farm profit (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a. 1

2. Net profit (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), line 15a (other than farming); and Schedule K-1 (Form 1065-SE), box 3. Minus line 15 of prior year's Schedule SE. 2 18,304.

3. Combine lines 1 and 2. 3 18,304.

4. Net earnings from self-employment. Multiply line 3 by 92.35% (0.9235). If less than $400, do not file this schedule; you do not owe self-employment tax. 4 16,904.

5. Self-employment tax. If the amount on line 4 is $84,500 or less, multiply line 4 by 15.3% (0.153). Enter the result here and on Form 1040, line 56. 5

6. Enter the result here and on Form 1040, line 23. Deduction for one-half of self-employment tax. Multiply line 5 by 50% (0.5). 6 2,586.

BAA For Paperwork Reduction Act Notice, see Form 1040 instructions.
### Depreciation and Amortization (Including Information on Listed Property)

**Note:** If you have any listed property, complete Part V before you complete Part I.

|   | Description of property | (b) Cost or basis (use only) | (c) Election cost
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>FURNITURE &amp; FIXTURES</td>
<td>$19,000.00</td>
<td>$19,000.00</td>
</tr>
<tr>
<td>2</td>
<td>COMPUTER</td>
<td>$40,000.00</td>
<td>$5,000.00</td>
</tr>
</tbody>
</table>

**Note:** Do not use Part II or Part III below if listed property. Instead, use Part V.

### Part II Special Depreciation Allowance and Other Depreciation (Do not include listed property)

- 14. Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year (see instructions).
- 15. Property subject to section 168(f)(1) election (see instructions).
- 16. Other depreciation (including ACRS) (see instructions).

### Part III MACRS Depreciation (Do not include listed property) (See instructions)

#### Section A
- 17. MACRS deductions for assets placed in service in tax years beginning before 2002.
- 18. If you are electing under section 168(f)(4) to group any assets placed in service during the tax year into one or more general asset accounts, check here.

#### Section B - Assets Placed in Service During 2002 Tax Year Using the General Depreciation System

<table>
<thead>
<tr>
<th>(a) Classification of property</th>
<th>(b) Year and month placed in service</th>
<th>(c) Basis for depreciation (use only — see instructions)</th>
<th>(d) Recovery period</th>
<th>(e) Convention</th>
<th>(f) Method</th>
<th>(g) Depreciation deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>19a. 3-year property</td>
<td>24,500.00</td>
<td>HY</td>
<td>5.0 yrs</td>
<td>200DB</td>
<td>$4,900.00</td>
<td></td>
</tr>
<tr>
<td>19b. 5-year property</td>
<td>25 yrs</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19c. 7-year property</td>
<td>27.5 yrs</td>
<td>MM</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19d. 10-year property</td>
<td>27.5 yrs</td>
<td>MM</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19e. 15-year property</td>
<td>35 yrs</td>
<td>MM</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19f. 20-year property</td>
<td>35 yrs</td>
<td>MM</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19g. 25-year property</td>
<td>35 yrs</td>
<td>MM</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19h. Residential rental</td>
<td>35 yrs</td>
<td>MM</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19i. Nonresidential real</td>
<td>35 yrs</td>
<td>MM</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19j. Property</td>
<td>35 yrs</td>
<td>MM</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Section C - Assets Placed in Service During 2002 Tax Year Using the Alternative Depreciation System

<table>
<thead>
<tr>
<th>(a) Class life</th>
<th>(b) Summary (see instructions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20a. 12-year</td>
<td>12 yrs</td>
</tr>
<tr>
<td>20b. 40-year</td>
<td>40 yrs</td>
</tr>
</tbody>
</table>

### Part IV Summary (see instructions)

- 22. Total Add amounts from line 21, lines 19 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations — see instructions.
- 23. For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs.
59. continued

### Part V

**Listed Property** (Include automobiles, certain other vehicles, cellular telephones, certain computers, and property used for entertainment, recreation, or amusement.)

**Note:** For any vehicle for which you are using the standard mileage rate or deducting lease expenses, complete only 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

#### Section A - Depreciation and Other Information (Caution: See instructions for limits for passenger automobiles.)

| (a) Type of property (use form 4562) | (b) Date placed in service | (c) Basis for investment
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(d) Cost or other basis</td>
<td>(e) Basis for depreciation (business use only)</td>
<td>(f) Recovery period</td>
</tr>
<tr>
<td>(g) Method/Convention</td>
<td>(h) Depreciation deduction</td>
<td>(i) Election of special section 179 cost</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(a) Type of property (automobile)</th>
<th>(b) Date placed in service</th>
<th>(c) Basis for investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>(d) Cost or other basis</td>
<td>(e) Basis for depreciation (business use only)</td>
<td>(f) Recovery period</td>
</tr>
<tr>
<td>(g) Method/Convention</td>
<td>(h) Depreciation deduction</td>
<td>(i) Election of special section 179 cost</td>
</tr>
</tbody>
</table>

### 24a
- Do you have evidence to support the business investment used during the year? **Yes**
- If yes, is the evidence written? **No**

<table>
<thead>
<tr>
<th>(a) Type of property (automobile)</th>
<th>(b) Date placed in service</th>
<th>(c) Basis for investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>(d) Cost or other basis</td>
<td>(e) Basis for depreciation (business use only)</td>
<td>(f) Recovery period</td>
</tr>
<tr>
<td>(g) Method/Convention</td>
<td>(h) Depreciation deduction</td>
<td>(i) Election of special section 179 cost</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(a) Type of property (automobile)</th>
<th>(b) Date placed in service</th>
<th>(c) Basis for investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>(d) Cost or other basis</td>
<td>(e) Basis for depreciation (business use only)</td>
<td>(f) Recovery period</td>
</tr>
<tr>
<td>(g) Method/Convention</td>
<td>(h) Depreciation deduction</td>
<td>(i) Election of special section 179 cost</td>
</tr>
</tbody>
</table>

### 26
- Property used more than 50% in a qualified business use (see instructions):

<table>
<thead>
<tr>
<th>AUTOMOBILE</th>
<th>01/05/02</th>
<th>60,000</th>
<th>37,000</th>
<th>17,604</th>
<th>5.00</th>
<th>2000DB/HY</th>
<th>0.</th>
</tr>
</thead>
</table>

### 27
- Property used 50% or less in a qualified business use (see instructions):

<table>
<thead>
<tr>
<th>AUTOMOBILE</th>
<th>01/05/02</th>
<th>60,000</th>
<th>37,000</th>
<th>17,604</th>
<th>5.00</th>
<th>2000DB/HY</th>
<th>0.</th>
</tr>
</thead>
</table>

### Part B - Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other more than 5% owner, or related person. If you provided vehicles to your employees, answer the questions in Section C to see if you meet an exception to completing this section on those vehicles.

<table>
<thead>
<tr>
<th>(a) Vehicle 1</th>
<th>(b) Vehicle 2</th>
<th>(c) Vehicle 3</th>
<th>(d) Vehicle 4</th>
<th>(e) Vehicle 5</th>
<th>(f) Vehicle 6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total business/investment miles driven during the year</td>
<td>4,200</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total commuting miles driven during the year</td>
<td>2,800</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total other personal (noncommuting) miles driven</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total miles driven during the year</td>
<td>7,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Yes**

**No**

### Section C - Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who are **not** more than 5% owners or related persons (see instructions).

**Yes**

**No**

<table>
<thead>
<tr>
<th>Question</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?</td>
<td>Yes</td>
</tr>
<tr>
<td>38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees?</td>
<td>No</td>
</tr>
<tr>
<td>39 Do you treat all use of vehicles by employees as personal use?</td>
<td>Yes</td>
</tr>
<tr>
<td>40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received?</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Note:** If your answer to 37, 38, 39, or 40 is “Yes,” do not complete Section B for the covered vehicles.

### Part VI Amortization

<table>
<thead>
<tr>
<th>(a) Description of costs</th>
<th>(b) Date amortization begins</th>
<th>(c) Amortizable amount</th>
<th>(d) Code section</th>
<th>(e) Amortization period or percentage</th>
<th>(f) Amortization for this year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amortization of costs that begins during your 2002 tax year (see instructions):</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(a) Description of costs</th>
<th>(b) Date amortization begins</th>
<th>(c) Amortizable amount</th>
<th>(d) Code section</th>
<th>(e) Amortization period or percentage</th>
<th>(f) Amortization for this year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amortization of costs that began before your 2002 tax year:</td>
<td>43</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(a) Description of costs</th>
<th>(b) Date amortization begins</th>
<th>(c) Amortizable amount</th>
<th>(d) Code section</th>
<th>(e) Amortization period or percentage</th>
<th>(f) Amortization for this year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total: Add amounts in column (f). See instructions for where to report</td>
<td>44</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>