## CHAPTER 12

PROPERTY TRANSACTIONS: DETERMINATION OF GAIN OR LOSS, BASIS CONSIDERATIONS, AND NONTAXABLE EXCHANGES

SOLUTIONS TO PROBLEM MATERIALS

<table>
<thead>
<tr>
<th>Question/Problem</th>
<th>Topic</th>
<th>Status: Present</th>
<th>Q/P in Prior Edition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Sale or other disposition</td>
<td>Unchanged</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Sale or other disposition versus mere change in value</td>
<td>Modified</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>Amount realized: determination of</td>
<td>Unchanged</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>Basis and effect of liability</td>
<td>Unchanged</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>Basis: note versus cash</td>
<td>Unchanged</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>Amount realized and basis considerations</td>
<td>Unchanged</td>
<td>6</td>
</tr>
<tr>
<td>7</td>
<td>Basis and cost recovery: allowed versus allowable depreciation</td>
<td>Unchanged</td>
<td>7</td>
</tr>
<tr>
<td>8</td>
<td>Basis and cost recovery: effect of depreciation</td>
<td>Unchanged</td>
<td>8</td>
</tr>
<tr>
<td>9</td>
<td>Corporate distributions</td>
<td>Unchanged</td>
<td>9</td>
</tr>
<tr>
<td>10</td>
<td>Sale of personal use assets: gain versus loss</td>
<td>Unchanged</td>
<td>10</td>
</tr>
<tr>
<td>11</td>
<td>Issue ID</td>
<td>Unchanged</td>
<td>11</td>
</tr>
<tr>
<td>12</td>
<td>Bargain purchase by shareholder and effect on stock basis</td>
<td>Modified</td>
<td>12</td>
</tr>
<tr>
<td>13</td>
<td>Lump-sum purchase, basis, and goodwill</td>
<td>Unchanged</td>
<td>13</td>
</tr>
<tr>
<td>14</td>
<td>Gift basis: gain basis and loss basis</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Issue ID</td>
<td>Unchanged</td>
<td>14</td>
</tr>
<tr>
<td>16</td>
<td>Gift basis and adjustment for gift tax paid: pre 1977 and post 1976</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Property transferred by gift versus inheritance</td>
<td>Unchanged</td>
<td>16</td>
</tr>
<tr>
<td>18</td>
<td>Basis for inherited property</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Like-kind exchanges</td>
<td>Unchanged</td>
<td>18</td>
</tr>
<tr>
<td>20</td>
<td>Issue ID</td>
<td>Unchanged</td>
<td>19</td>
</tr>
<tr>
<td>21</td>
<td>Issue ID</td>
<td>Unchanged</td>
<td>20</td>
</tr>
<tr>
<td>22</td>
<td>Like-kind exchanges: partnership interests</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>Effect of boot on recognition and basis</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>Question/Problem</td>
<td>Topic</td>
<td>Status: Present Edition</td>
<td>Q/P in Prior Edition</td>
</tr>
<tr>
<td>------------------</td>
<td>-------</td>
<td>-------------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>24</td>
<td>Holding period in a like-kind exchange</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>Involuntary conversion: definition</td>
<td>Unchanged</td>
<td>24</td>
</tr>
<tr>
<td>26</td>
<td>Involuntary conversion: severance award</td>
<td>Unchanged</td>
<td>25</td>
</tr>
<tr>
<td>27</td>
<td>Involuntary conversion: qualification requirements</td>
<td>Modified</td>
<td>26</td>
</tr>
<tr>
<td>28</td>
<td>Involuntary conversion: replacement time period</td>
<td>Unchanged</td>
<td>27</td>
</tr>
<tr>
<td>29</td>
<td>Involuntary conversion: condemnation</td>
<td>Unchanged</td>
<td>28</td>
</tr>
<tr>
<td>30</td>
<td>Issue ID</td>
<td>Unchanged</td>
<td>29</td>
</tr>
<tr>
<td>31</td>
<td>Involuntary conversion: holding period</td>
<td>Unchanged</td>
<td>30</td>
</tr>
<tr>
<td>32</td>
<td>Sale of residence: qualification and election to forgo</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>33</td>
<td>Sale of residence</td>
<td>Unchanged</td>
<td>32</td>
</tr>
<tr>
<td>34</td>
<td>Issue ID</td>
<td>Unchanged</td>
<td>33</td>
</tr>
<tr>
<td>35</td>
<td>Sale of residence: partial excusion</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>36</td>
<td>Specialized small business investment company</td>
<td>Unchanged</td>
<td>34</td>
</tr>
<tr>
<td>* 37</td>
<td>Amount realized and basis determination</td>
<td>Unchanged</td>
<td>35</td>
</tr>
<tr>
<td>* 38</td>
<td>Amount realized and basis determination</td>
<td>Unchanged</td>
<td>36</td>
</tr>
<tr>
<td>* 39</td>
<td>Basis and cost recovery adjustment</td>
<td>Unchanged</td>
<td>37</td>
</tr>
<tr>
<td>* 40</td>
<td>Personal use asset sale, exchange, or casualty</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>* 41</td>
<td>Corporate distributions that are a return of capital</td>
<td>Modified</td>
<td>39</td>
</tr>
<tr>
<td>* 42</td>
<td>Realization versus recognition, sale of personal use assets</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>* 43</td>
<td>Recognition and condemnation</td>
<td>Unchanged</td>
<td>40</td>
</tr>
<tr>
<td>44</td>
<td>Bargain purchase by employee</td>
<td>Unchanged</td>
<td>41</td>
</tr>
<tr>
<td>* 45</td>
<td>Basis and cost identification of stock</td>
<td>Unchanged</td>
<td>42</td>
</tr>
<tr>
<td>* 46</td>
<td>Basis and cost identification of stock</td>
<td>Unchanged</td>
<td>43</td>
</tr>
<tr>
<td>* 47</td>
<td>Allocation of purchase price to goodwill</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>48</td>
<td>Nontaxable stock rights</td>
<td>Unchanged</td>
<td>45</td>
</tr>
<tr>
<td>49</td>
<td>Gift basis: gain basis and loss basis</td>
<td>Unchanged</td>
<td>46</td>
</tr>
<tr>
<td>50</td>
<td>Gift basis of depreciable property</td>
<td>Unchanged</td>
<td>47</td>
</tr>
<tr>
<td>51</td>
<td>Gift basis: gain basis and loss basis</td>
<td>Modified</td>
<td>48</td>
</tr>
<tr>
<td>52</td>
<td>Gift basis: charitable contribution considerations</td>
<td>Unchanged</td>
<td>49</td>
</tr>
<tr>
<td>53</td>
<td>Basis for inherited property: alternate valuation date</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>54</td>
<td>Deathbed gifts: basis of property</td>
<td>Unchanged</td>
<td>51</td>
</tr>
<tr>
<td>* 55</td>
<td>Basis for inherited property: community property</td>
<td>Unchanged</td>
<td>52</td>
</tr>
<tr>
<td>56</td>
<td>Related party loss disallowance</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>57</td>
<td>Related party loss disallowance</td>
<td>Unchanged</td>
<td>53</td>
</tr>
<tr>
<td>58</td>
<td>Wash sales</td>
<td>Unchanged</td>
<td>54</td>
</tr>
<tr>
<td>59</td>
<td>Wash sales</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>* 60</td>
<td>Property converted from personal use</td>
<td>Unchanged</td>
<td>56</td>
</tr>
<tr>
<td>61</td>
<td>Selection of property for making gifts and bequests</td>
<td>Unchanged</td>
<td>57</td>
</tr>
<tr>
<td>* 62</td>
<td>Like-kind exchange: recognition and basis</td>
<td>Modified</td>
<td>58</td>
</tr>
<tr>
<td>* 63</td>
<td>Like-kind exchange: mandatory nature</td>
<td>Unchanged</td>
<td>59</td>
</tr>
<tr>
<td>* 64</td>
<td>Like-kind exchange: related party</td>
<td>Unchanged</td>
<td>60</td>
</tr>
<tr>
<td>* 65</td>
<td>Like-kind exchange: like-kind property and boot</td>
<td>Unchanged</td>
<td>61</td>
</tr>
<tr>
<td>* 66</td>
<td>Like-kind exchange: realized loss and holding period</td>
<td>Unchanged</td>
<td>62</td>
</tr>
<tr>
<td>* 67</td>
<td>Like-kind exchange: personal use asset</td>
<td>Modified</td>
<td>63</td>
</tr>
<tr>
<td>* 68</td>
<td>Like-kind exchange: boot received</td>
<td>Modified</td>
<td>64</td>
</tr>
<tr>
<td>Question/Problem</td>
<td>Topic</td>
<td>Status: Present Edition</td>
<td>Q/P in Prior Edition</td>
</tr>
<tr>
<td>-----------------</td>
<td>----------------------------------------------------------------------</td>
<td>-------------------------</td>
<td>----------------------</td>
</tr>
<tr>
<td>* 69</td>
<td>Like-kind exchange: three parties</td>
<td>Unchanged</td>
<td>65</td>
</tr>
<tr>
<td>* 70</td>
<td>Like-kind exchange: form of the transaction</td>
<td>Unchanged</td>
<td>66</td>
</tr>
<tr>
<td>* 71</td>
<td>Like-kind exchange: mortgage assumed as boot</td>
<td>Unchanged</td>
<td>67</td>
</tr>
<tr>
<td>* 72</td>
<td>Like-kind exchange: recognition, boot, and basis</td>
<td>Unchanged</td>
<td>68</td>
</tr>
<tr>
<td>* 73</td>
<td>Like-kind exchange and mortgage assumed</td>
<td>Unchanged</td>
<td>69</td>
</tr>
<tr>
<td>* 74</td>
<td>Involuntary conversion: recognized loss</td>
<td>Modified</td>
<td>70</td>
</tr>
<tr>
<td>* 75</td>
<td>Involuntary conversion: severance award</td>
<td>Unchanged</td>
<td>71</td>
</tr>
<tr>
<td>76</td>
<td>Involuntary conversion: qualifying replacement property</td>
<td>Unchanged</td>
<td>72</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>77</td>
<td>Involuntary conversion: recognition, basis, and replacement time period</td>
<td>Unchanged</td>
<td>73</td>
</tr>
<tr>
<td>78</td>
<td>Involuntary conversion: recognition and basis</td>
<td>Unchanged</td>
<td>74</td>
</tr>
<tr>
<td>* 79</td>
<td>Involuntary conversion: recognition, basis, and replacement time period</td>
<td>Unchanged</td>
<td>75</td>
</tr>
<tr>
<td>* 80</td>
<td>Sale of residence: qualification, recognition, and basis</td>
<td>Unchanged</td>
<td>76</td>
</tr>
<tr>
<td>* 81</td>
<td>Sale of residence: qualification and recognition</td>
<td>New</td>
<td></td>
</tr>
<tr>
<td>* 82</td>
<td>Sale of residence: calculation of § 121 exclusion</td>
<td>Unchanged</td>
<td>78</td>
</tr>
<tr>
<td>* 83</td>
<td>Sale of residence: eligibility for § 121 exclusion for a married couple</td>
<td>Modified</td>
<td>79</td>
</tr>
<tr>
<td>* 84</td>
<td>Sale of residence: selling before or after marriage</td>
<td>Unchanged</td>
<td>80</td>
</tr>
<tr>
<td>* 85</td>
<td>Section 121 exclusion: multiple owners</td>
<td>Unchanged</td>
<td>81</td>
</tr>
<tr>
<td>* 86</td>
<td>Involuntary conversion and § 121 exclusion</td>
<td>Modified</td>
<td>82</td>
</tr>
<tr>
<td>* 87</td>
<td>Transfer of property between spouses or incident to divorce</td>
<td>Unchanged</td>
<td>83</td>
</tr>
<tr>
<td>* 88</td>
<td>Cumulative</td>
<td>Unchanged</td>
<td>84</td>
</tr>
<tr>
<td>* 89</td>
<td>Cumulative</td>
<td>Modified</td>
<td>85</td>
</tr>
<tr>
<td>* 90</td>
<td>Cumulative</td>
<td>Unchanged</td>
<td>86</td>
</tr>
</tbody>
</table>

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

37. $62,500.
38.a. $73,500 gain.
38.b. $93,500 gain.
38.c. $93,500 gain.
39.a. $24,000.
39.b. $351,000.
40.a. $0.
40.b. $0.
40.c. $0.
41.a. $60,000 return of capital.
41.b. Recognized gain $8,000; stock basis $0.
41.c. Basis $72,000.
42. Recognized gain $4,100.
43.a. $0.
43.b. $10,000.
43.c. $20,000 loss.
44.a. Yes, $125,000.
44.b. $350,000.
45.a. $0.
45.b. Realized loss $900.
45.c. Realized gain $2,700.
45.d. MDG: Realized gain $2,400; GRU: Realized gain $13,875.
46.a. $210,000.
46.b. $39,000 loss.
46.c. $39,000 loss.
47.a. $500,000.
47.b. Goodwill $120,000.
48.a. $4,286.
48.b. $714.
48.c. Recognized gain $486.
48.d. Stock basis $5,000.
48.e. Adjusted basis of stock $5,000; adjusted basis of stock rights $0.
49.a. $57,000 gain.
49.b. $30,000 gain.
49.c. $4,000 loss.
49.d. $0.
50.a. $10,000.
50.b. $5,000.
50.c. $100 loss.
50.d. $1,000 gain.
51. $0.
53.a. $2,780,000.
53.b. $2,500,000.
54.a. $3,000.
54.b. $5,500.
55.a. $200,000.
55.b. $175,000.
56.a. $0 recognized loss.
56.b. $0 recognized gain.
56.c. $10,000 recognized gain.
56.d. $5,000 recognized loss.
57.a. Parcel A $25,000 recognized loss; Parcel B $5,000 recognized loss; Parcel C $0 recognized loss.
57.b. Recognized gain $40,000.
57.c. Recognized gain $10,000.
57.d. Recognized gain $0.
58.a. Recognized loss $0; basis $42,000.
58.b. $35,000.
58.c. Same consequences.
59.a. Recognized gain $7,000.
59.b. Yes.
59.c. $0.
60.a. Gain basis $130,000; loss basis $125,000; cost recovery basis $95,000.
60.b. $11,980.
60.c. $61,980 (house); $7,500 (land).
60.d. Realized gain $78,000; recognized gain $0.
61.a. $212,000.
62.a. Realized gain on exchange $12,000; recognized gain on exchange $3,000; adjusted basis $80,000.
62.b. Realized gain on exchange $17,000; recognized gain on exchange $0; adjusted basis of $75,000.
62.c. Realized gain $45,000; recognized gain $45,000.
62.d. Realized gain $9,000; recognized gain $9,000; adjusted basis is $89,000.
63.a. Realized gain $6,000; recognized gain $2,000; adjusted basis for gray bus $5,000; adjusted basis for equipment $4,000.
63.b. Realized gain $6,000; recognized gain $2,000; adjusted basis for yellow bus $5,000.
66.a. $18,000 adjusted basis.
66.c. $14,000 adjusted basis.
67.a. Realized loss $14,000; recognized loss $0.
67.b. Basis is $30,000.
67.c. Date of purchase.
68.a. Realized gain $150,000.
68.b. Recognized gain $100,000.
68.c. Basis of land $125,000; basis of stock $100,000.
68.d. Realized and recognized gain $150,000; basis for land $100,000; basis for stock $175,000.
69.a. Realized gain $140,000; recognized gain $0; basis $35,000.
69.b. Realized and recognized gain $0; basis $175,000.
70.a. $3,000; $3,000.
70.b. Basis $15,000.
70.d. ($3,000); ($3,000).
71.a. Frank: realized gain $28,000; recognized gain $0. Tom: realized gain $32,000; recognized gain $12,000.
71.b. Frank $64,000; Tom $60,000.
71.c. Same effect.
73.a. Realized gain $415,000.
73.b. Recognized gain $390,000.
73.c. $950,000 adjusted basis.
74. Realized and recognized loss $12,000.
75.a. Realized and recognized gain $5,000.
75.b. Basis reduced to $89,000.
76.a. Yes.
76.b. Yes.
76.c. Yes.
76.d. No.
76.e. No.
77.b. Realized gain $62,000; recognized gain $12,000.
77.c. $150,000.
77.d. Realized and recognized gain $62,000.
77.e. Same as d.
78.a. Postponed gain $0; basis $110,000.
78.b. Postponed loss $0; basis $175,000.
78.c. Postponed gain $100,000; basis $350,000.
78.d. Postponed loss $0; basis $17,000.
78.e. Postponed gain $60,000; basis $160,000.
78.f. Postponed gain $1,000; basis $18,000.
78.g. Postponed loss $0; basis $26,000.
78.h. Postponed gain $50,000; basis $150,000.
79.a. Recognized gain $10,000.
80.a. Realized gain $167,000.
80.b. Recognized gain $167,000.
80.c. Basis $300,000.
81.a. Realized gain $55,000; § 121 exclusion $55,000; recognized gain $0.
81.b. Realized gain $65,000; § 121 exclusion $0; recognized gain $65,000.
81.c. Accept the $230,000 offer.
82.a. Realized gain $320,000; § 121 exclusion $250,000; recognized gain $70,000; basis $0.
82.b. Realized gain $141,000; § 121 exclusion $141,000; recognized gain $0; basis $260,000.
82.c. Realized gain $413,000; § 121 exclusion $340,000; recognized gain $70,000; basis $0.
82.d. Realized loss $1,000; recognized loss $0; basis $80,000.
82.e. Realized gain $66,000; § 121 exclusion $66,000; recognized gain $0; basis $120,000.
83.a. Realized gain $340,000; § 121 exclusion $340,000; recognized gain $0.
83.b. Realized gain $340,000; § 121 exclusion $250,000; recognized gain $90,000.
83.c. Realized gain $550,000; § 121 exclusion $500,000; recognized gain $50,000.
83.d. Realized gain $550,000; § 121 exclusion $250,000; recognized gain $300,000.
84.a. Meg: realized gain $335,000; § 121 exclusion $250,000; recognized gain $85,000. Walt: realized gain $111,000; § 121 exclusion $111,000; recognized gain $0.
84.c. Basis $400,000.
85.a. Each sister: realized gain $205,000; § 121 exclusion $205,000; recognized gain $0.
86.a. Realized gain $180,000; § 121 exclusion $180,000; recognized gain $0.
87.a. Realized gain $45,000; recognized gain $0.
87.b. Basis $35,000.
87.c. Same effect.
88. Refund due for 2002 $1,334.
89. Refund due for 2003 $1,604.
90. Refund due for 2002 $1,216.
DISCUSSION QUESTIONS

1. Over the 5-year period, the results for Ivan and Grace are the same (i.e., recognized gain of $40,000). However, the timing of the recognition of the gain differs. Grace will include the interest income of $8,000 in her gross income for each of the 5 years. Ivan will recognize his $40,000 gain in the fifth year when he sells the land (i.e., mere fluctuation in value is not a disposition or identifiable event for tax purposes). In addition, the character of the income is different. The interest is ordinary income and the land sale is probably a long-term capital gain. p. 12-3 and Example 3

2. While the stock owned by Carol and by Dave decreases in value by $2,000, only Carol has a realized and recognized loss of $2,000. The key factor in determining whether a disposition has taken place usually is whether an identifiable event has occurred. Carol's stock sale qualifies as a disposition whereas Dave's stock value decrease does not qualify as a disposition. p. 12-3 and Example 3

3. a. Whether the property is sold for cash or on credit is not relevant for this purpose. The amount realized includes both the cash received at the time of sale and the cash to be received in the future (i.e., the payments made by the debtor).

b. The mortgage assumption increases the amount realized by the seller.

c. The buyer’s acquisition of the property subject to the mortgage of the seller increases the amount realized by the seller.

d. The payment of property taxes by the seller that are treated as imposed on the purchaser decreases the amount realized by the seller. The payment by the seller is, in effect, a reduction in the amount received by the seller of the property.

e. The receipt of the stock worth $10,000 by the seller increases the amount realized by $10,000.

p. 12-4 and Example 4

4. Under the first option, the basis for the land consists of the sum of the cash paid by Tom ($90,000) and the mortgage on the land ($65,000) which Tom would assume. The basis under the second option is the $155,000 paid by Tom. Therefore, Tom’s basis will be the same regardless of which option he selects. However, the first option will require a smaller current cash outflow. The same current cash outflow of $90,000 could be achieved under the second option if Tom were to place a $65,000 mortgage on the land immediately. However, this may result in additional closing costs. pp. 12-3 and 12-4

5. a. Edith’s basis is the cost of $390,000 ($90,000 + $300,000). Whether the full acquisition price is paid in cash is not relevant.

b. Edith’s basis for the land remains at $390,000. The interest paid does not affect the adjusted basis.

p. 12-4

6. a. One factor that could contribute to this result is that mortgages are granted based on the fair market value of the property rather than based on the taxpayer’s adjusted basis for the property. Another factor is that depreciation deductions in
the early life of the asset may have exceeded the amortization of the mortgage principal.

b. The amount realized is $360,000, the full amount of the debt forgiveness. The Supreme Court ruled in *Tufts* that the fair market value of the property does not serve as a ceiling on the debt forgiveness in calculating the amount realized. The adjusted basis is not affected (i.e., it remains at $75,000). Therefore, the realized gain is $285,000 ($360,000 – $75,000).

c. No. In either case, the amount realized is $360,000. The justification for this treatment for the nonrecourse mortgage is that the taxpayer initially benefited when the mortgage was incurred in terms of increasing the property’s adjusted basis (e.g., if the purchase price is $500,000 of which $400,000 is financed by a nonrecourse mortgage, the basis is $500,000).

7. As discussed in Chapter 7, allowed depreciation is the depreciation actually deducted, whereas allowable depreciation is the amount that could have been deducted under the applicable depreciation method. In most circumstances, the allowed and allowable depreciation amounts are the same. The adjusted basis of the property is reduced by the greater of the allowed or allowable depreciation. See Chapter 7. p. 12-5

8. a. Todd’s adjusted basis at acquisition date is:
   
<table>
<thead>
<tr>
<th>Asset</th>
<th>Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$100,000</td>
</tr>
<tr>
<td>Building</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

b. His adjusted basis at the end of 2003 is:
   
<table>
<thead>
<tr>
<th>Asset</th>
<th>Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>$100,000</td>
</tr>
<tr>
<td>Building</td>
<td>($200,000 – $1,926) $198,074</td>
</tr>
</tbody>
</table>

9. Dividend treatment will result only if the corporation has adequate earnings and profits to cover the amount of the distribution. Any excess of the amount of the distribution over the earnings and profits will be treated as a recovery of capital. In the case of a recovery of capital, the basis of the stock is reduced. Once the basis of the stock is reduced to zero, the amount of any subsequent distributions is a capital gain if the stock is a capital asset. p. 12-6

10. a. Both cars are personal use assets. Therefore, Tracy cannot recognize the realized loss of $7,000 ($15,000 amount realized – $22,000 adjusted basis) on the sale of the red car, and she must recognize the realized gain of $2,500 ($15,500 amount realized – $13,000 adjusted basis) on the sale of the blue car. Her adjusted basis for the new car is the cost of $25,000.

b. No. The tax consequences of the exchange would be the same as the sale and purchase. Tracy’s realized loss of $7,000 ($15,000 amount realized – $22,000 adjusted basis) is disqualified because the red car is a personal use asset. Her adjusted basis for the new car is the cost of $25,000.

pp. 12-7, 12-8 and Examples 8 and 9
11. Both assets are personal use assets. Therefore, gains are recognized and losses are not recognized. Ron may think that if he sells both assets this year he can net the gain and loss. Unfortunately, this is not permitted. By accepting Jeff’s offer, Ron can defer the $5,000 realized gain on the sale of the motorcycle until next year. p. 12-7

12. If the fair market value of the lot is $100,000, then Helen has made a bargain purchase of $20,000 ($100,000 FMV – $80,000 purchase price). In this case, Helen recognizes income of $20,000, and her basis in the lot becomes $100,000 ($80,000 purchase price + $20,000 recognized income, or $100,000 FMV). If the fair market value of the lot is only $90,000, then Helen’s recognized gain is $10,000 ($90,000 FMV – $80,000 purchase price), and her basis in the lot is $90,000 ($80,000 purchase price + $10,000 recognized gain, or $90,000 FMV). p. 12-9 and Example 10

13. In a lump-sum purchase, cost is allocated according to the relative fair market values of the individual assets acquired. However, if a business is purchased and goodwill is involved, § 1060 requires that the allocation be made according to the residual method. Under the residual method when a business is purchased, the purchase price is assigned to the assets, excluding goodwill, based on their respective fair market value. Any excess (i.e., the residual) of the purchase price over the summation of these fair market value amounts is assigned to the goodwill. pp. 12-9, 12-10, and Example 12

14. The statutory intent is that gift property should have a carryover basis to the donee (i.e., donor’s basis plus a possible adjustment for part or all of the gift tax paid). Thus, assuming no gift tax is paid and the fair market value of the property does not change from the original acquisition date, the donee’s realized gain on the disposition of the property will be the same as that which would have resulted if the donor had sold the property. While the Code provides a carryover basis with respect to gains, it does so with respect to losses only if the fair market value of the property at the date of the gift is at least equal to the donor’s adjusted basis. If the adjusted basis exceeds the fair market value at the date of the gift, the loss basis rule prevents such an excess from being passed on to the donee by using the “lower of” approach. The gain basis rule and the loss basis rule will produce different basis amounts only if the fair market value of the property at the date of the gift is less than the donor’s adjusted basis. pp. 12-12 and 12-13

15. Either Simon or Fred should receive the benefit of deducting the realized loss on the sale of the stock. On the surface, it appears that Simon should give the stock to Fred and let Fred sell it, since Fred is in the higher tax bracket (i.e., 27% versus Simon’s 15%). However, a taxpayer cannot deduct another taxpayer’s loss. For gift property, this is achieved by the loss basis to the donee being the lower of (1) the donor’s adjusted basis, or (2) the fair market value on the date of the gift. Therefore, since the stock has declined in value (i.e., adjusted basis is greater than the fair market value at the date of the gift), Simon should sell the stock, deduct the realized loss, and give the sales proceeds to Fred). p. 12-13 and Example 19

16. Tax legislation enacted in 1976 changed the provision for calculating the gain basis of property received by gift when gift tax is paid. For gifts made before 1977 (i.e., the effective date for the change), the basis is the sum of the donor’s adjusted basis plus the gift tax paid. For gifts made after 1976, the basis is the sum of the donor’s adjusted basis plus the gift tax paid associated with the appreciation of the property. The formula for this calculation is as follows:

\[
\text{Donor’s basis} + \left( \text{Unrealized appreciation} \times \text{Gift tax paid} \right)
\]
Regardless of when the gift is made (i.e., before 1977 or after 1976), the amount of the gift tax added cannot increase the basis beyond the fair market value of the property. p. 12-14

17. If an asset is held until its owner’s death, the adjusted basis to the heirs is its fair market value at the date of death (or other valuation elected). Holding appreciated property until death, instead of selling it, will avoid the recognition of gain. However, the property retained by the decedent may be subject to the Federal estate tax. Selling business or income-producing property that has declined in value before death results in a deductible loss. p. 12-16

18. If Thelma received the land as a gift from Aunt Sadie, her holding period would include not only her own holding period but also that of Aunt Sadie. Thus, if the land had been received by gift, Thelma’s holding period would not be long-term (i.e., 6 months plus 3 months). For inherited property, however, Thelma’s holding period is automatically long-term. Therefore, she can sell it now and qualify for long-term capital gain treatment. p. 12-19

19. a. Yes.

b. No. Inventory does not qualify as productive use or investment property.

c. No. An exchange of investment realty for a personal residence does not qualify.

d. No. Securities do not qualify as productive use or investment property.

e. Yes.

f. No. Although the truck and the computer both are business personalty, they are not in the same general business asset class.

g. Yes.

h. No. Stock in different corporations does not qualify as like-kind property under § 1031.

i. Yes. The office furniture and office equipment both are personalty and they are in the same general business asset class.

j. No. Real property located in the United States exchanged for foreign real property (and vice versa) does not qualify as like-kind property.

pp. 12-28 to 12-30

20. Since the Spring Creek lot has appreciated substantially, Melissa probably would like for the exchange to qualify for § 1031 postponement. She can defer the realized gain until the McComb lot is disposed of in a taxable transaction. However, she needs to be aware of the special provision that applies to related party exchanges. If her father disposes of the Spring Creek lot within two years of the date of the exchange, Melissa’s postponed gain is recognized at the time of such disposition. pp. 12-28 and 12-29
21. The critical question is whether the transactions qualify for § 1031 deferral treatment. His preference probably is to have the gain on the land deferred and the loss on the stock recognized. Therefore, the key is to be aware of whether the land and the stock to be received qualify as like-kind property. Since only the land qualifies, he can exchange the land (i.e., defer the realized gain) and either sell or exchange the stock (i.e., recognize the realized loss). However, Ross may want to sell the land in order to avoid § 1031 treatment and recognize the gain. This could be the case if Ross has no other recognized gains and current year deductibility of the stock loss would otherwise be limited to $3,000. pp. 12-27 and 12-28

22. No. Section 1031(b)(2) excludes partnership interests from qualifying for like-kind exchange treatment. p. 12-27

23. The basis of like-kind property that is received in a like-kind exchange can be calculated using either of the following formulas:

- Fair market value of like-kind property received – postponed gain + postponed loss.

- Adjusted basis of like-kind property surrendered + adjusted basis of boot given + gain recognized – fair market value of boot received – loss recognized.

The second formula illustrates the effect of boot on the basis of the like-kind property that is received. If the boot received is equal to or greater than the realized gain, all of the realized gain is recognized, and the basis of the like-kind property received is equal to or less than the adjusted basis of the like-kind property that was surrendered. If the boot received is less than the realized gain, only part of the realized gain is recognized, and the basis of the like-kind property received is equal to the adjusted basis of the like-kind property that was surrendered.

If there is no recognition of gain or loss on the boot given, the basis of the like-kind property that is received equals that of the like-kind property that was surrendered, increased by the adjusted basis of the boot given. If there is a recognition of gain or loss on the boot given, the basis of the like-kind property that is received is equal to that of the like-kind property that was surrendered, increased by both the recognized gain and the adjusted basis of the boot that was given and decreased by the recognized loss.

pp. 12-31 to 12-33

24. a. Since the exchange qualifies as a like-kind exchange, Beverly’s realized gain of $150,000 ($500,000 amount realized – $350,000 adjusted basis) is not recognized. Her basis for the developed real estate is a carryover basis of $350,000, and her holding period is a carryover holding period which begins September 25, 2000.

b. Beverly’s realized loss of $100,000 ($500,000 amount realized – $600,000 adjusted basis) is not recognized. Her basis for the developed real estate is a carryover basis of $600,000, and her holding period is a carryover holding period which begins September 25, 2000.

pp. 12-31 and 12-32

25. An involuntary conversion is the result of the destruction (complete or partial), theft, seizure, requisition or condemnation, or the sale or exchange under threat or imminence of requisition or condemnation of the taxpayer’s property. p. 12-34
26. Severance damages normally reduce the basis of the property. However, if either of the following requirements are satisfied for Ed, he can elect § 1033 postponement of any realized gain:

- Severance damages are used to restore the usability of the remaining property.
- The usefulness of the remaining property is destroyed by the condemnation and the property is sold and replaced at a cost equal to or exceeding the sum of the condemnation award, severance damages, and sales proceeds.

pp. 12-35 and 12-36

27. a. To qualify for §1033 full postponement of gain treatment, Tan must do the following:

- Elect §1033 postponement of gain treatment.
- Acquire qualifying property costing at least $520,000.
- Acquire the qualifying property no later than December 31, 2006.

b. Since the condemnation proceeds are less than Tan’s adjusted basis for the warehouse, Tan has a realized loss of $30,000 ($520,000 amount realized – $550,000 adjusted basis) on the condemnation. Losses on the condemnation of business property are automatically recognized. So, Tan does not need to make any type of election, and its recognized loss is $30,000.

pp. 12-34 to 12-39

28. a. The earliest date is October 1, 2003, the date of the threat or imminence of requisition or condemnation of the property. The latest date is June 30, 2007 (i.e., the end of the tax year the condemnation proceeds are received plus 3 years). Heather’s condemned property is investment real estate.

b. Both the earliest and the latest date are the same as in a. Heather’s condemned property is real estate used in its trade or business.

pp. 12-37 and 12-38

29. a. Under the general rule for involuntary conversions, the earliest date is the date of the occurrence of the event. However, if the form of the involuntary conversion is a condemnation, the earliest date is the date of the threat or imminence of requisition or condemnation of the property (i.e., May 3, 2003 for Bob). p. 12-38

b. Because Bob has reasonable grounds to believe that the property will be taken by the public housing authority, the sale to Carol qualifies as an involuntary conversion. p. 12-34

c. Even though Carol was aware of the condemnation at the date of acquisition, she may still qualify for §1033 treatment. The replacement deadline is three years after the close of the taxable year in which any gain is realized from the condemnation. Therefore, the latest date is December 31, 2006. pp. 12-34, 12-37, and 12-38
d. Because the form of the involuntary conversion is the condemnation of real property used in a business or held for investment, the apartment building can be replaced under the broader like-kind property replacement rules. p. 12-37

30. Martha should defer the realized gain on the disposition of the warehouse. Therefore, she should structure the transaction such that it will qualify as an involuntary conversion. Thus, the associated issues are whether the form of the disposition qualifies and whether the replacement qualifies. The acquisition by the condemning authority would qualify. Since the city is condemning the property, the sale to the real estate broker also would qualify. Replacing the warehouse with the office building will qualify since the form of the involuntary conversion is the condemnation of real property used in a trade or business. Unless Martha via the negotiation process can get more from the city than the real estate broker, she should sell the land to the real estate broker and replace it with the office building within the qualified replacement period (i.e., three years from the end of the tax year in which a proceeds inflow is received that is large enough to produce a gain). pp. 12-34 to 12-39

31. The replacement property that is acquired in an involuntary conversion is assigned a carryover basis and a carryover holding period. The carryover basis and holding period also applies for like-kind property received in a like-kind exchange. pp. 12-32 and 12-39

32. The sale of Gary’s principal residence qualifies for exclusion treatment under § 121. Under this provision, none of Gary’s realized gain of $235,000 ($235,000 realized gain – $250,000 exclusion) is recognized. However, Gary can elect to forgo the § 121 exclusion. In this case, his recognized gain is $235,000. Making this election to forgo the § 121 exclusion is beneficial only if Gary sells his new principal residence within a two-year period of the sale of the old residence and the realized gain is larger than $235,000. pp. 12-44 and 12-52

33. Congress has provided a limited exclusion of realized gain ($250,000 or $500,000) on the sale or exchange of a taxpayer’s principal residence. This is one of several beneficial provisions in the Code associated with home ownership that Congress has chosen to provide.

A taxpayer’s principal residence is a personal use asset. Losses on the sale or exchange of personal use assets are disallowed.

pp. 12-40 and 12-45

34. The issue is whether the sale of Sandy’s residence will qualify for § 121 exclusion treatment since she has a realized gain of $90,000. One reason that it would not qualify is that she may not have owned and used it as her principal residence for the requisite 2-year period. If this is the case, perhaps she could delay selling long enough to be able to satisfy this requirement. Another reason a sale would not qualify for the § 121 exclusion is if Sandy had a prior sale that qualified for § 121 treatment during the past 2 years. If she did, one planning approach would be to delay the sale for enough months until the 2-year rule is satisfied. pp. 12-41 to 12-44

35. Yes, a relief provision applies so that partial § 121 exclusion treatment may be available. Under this provision, the § 121 exclusion amount ($250,000 or $500,000) is multiplied by a fraction; the numerator of which is the number of qualifying months and the denominator of which is 24 months. The resulting amount is the maximum amount of excluded gain. The relief provision applies to the failure to meet the two-year ownership and occupancy requirement if the failure results from any of the following:
• Change in place of employment.
• Health.
• To the extent provided in the Regulations, other unforeseen circumstances.

pp. 12-41 to 12-44 and 12-46

36. Nancy’s adjusted basis for the Rose, Inc. stock is $8,000. Nancy sold publicly traded securities (Lime, Inc.) and reinvested the proceeds in the common stock of a specialized small business investment company (Rose, Inc.) within 60 days of the date of sale of the Lime, Inc. stock. Therefore, she qualifies for postponement of gain treatment under § 1044. Her adjusted basis for the Rose, Inc. stock is calculated as follows:

\[
\begin{align*}
\text{Adjusted basis for Lime stock} & \quad 5,000 \\
\text{Additional cash invested in Rose stock} \quad (10,000 - 7,000) & \quad 3,000 \\
\text{Adjusted basis for Rose stock} & \quad 8,000 \\
\end{align*}
\]

Alternatively, the adjusted basis of the Rose stock may be calculated as follows:

\[
\begin{align*}
\text{Cost of Rose stock} & \quad 10,000 \\
\text{Postponed gain} \quad (7,000 - 5,000) & \quad (2,000) \\
\text{Adjusted basis for Rose stock} & \quad 8,000 \\
\end{align*}
\]

pp. 12-47 and 12-48

PROBLEMS

37. Cost $190,000
   Add: Paving and sidewalks ($7,000 + $11,000) $18,000
   Elevator ($20,000 – $12,000) 8,000 26,000
   Subtotal $216,000
   Deduct: Depreciation deductions claimed $14,500
   Casualty insurance proceeds 13,500 Casualty loss allowed 5,500 (33,500)
   Adjusted basis $182,500

Amount realized ($260,000 – $15,000) $245,000
Less: Adjusted basis (182,500)
Realized gain $ 62,500

p. 12-5, Example 5, and Concept Summary 12-2

38. a. Original basis of land $10,000
   Original basis of house 70,000
   Less: Depreciation (32,200)
   Adjusted basis of house and land $47,800

   Original basis of tennis court $5,000
   Less: Depreciation (1,300)
   Adjusted basis of tennis court $3,700
Amount realized $125,000
Less: Adjusted basis ($47,800 + $3,700)
Realized gain $73,500

b. Amount realized [($125,000 (cash) + $20,000 (mortgage)] $145,000
Less: Adjusted basis (51,500)
Realized gain $93,500
c. Same answer as in part (b.) above.

pp. 12-3 to 12-5

39. a. Gayla must report on her income tax return the greater of the depreciation allowed of $20,000 ($24,000 X 10/12) or allowable of $24,000. The depreciation allowed is the amount actually deducted, whereas the depreciation allowable is the amount that should have been deducted under the depreciation convention. Gayla should amend her 2003 income tax return and deduct the correct amount of depreciation ($24,000).

b. Adjusted basis on January 1, 2003 $375,000
Less: Depreciation allowable (24,000)
Adjusted basis on December 31, 2003 $351,000

p. 12-5

40. a. Amount realized $14,500
Less: Adjusted basis (18,000)
Realized loss ($3,500)
Realized loss $-0-

Realized losses on the sale or exchange of personal use assets are not deductible.

b. Same result as in part (a) above.

c. Nell’s realized loss is $0. Since the form of the transaction is a theft, the realized loss is the lesser of the adjusted basis or the fair market value of the asset, reduced by the insurance proceeds that she received (see Chapter 6). Therefore, the opportunity for the theft loss deduction on personal use property is not present in this case because the insurance proceeds received of $14,500 equal the fair market value of $14,500. p. 12-7

41. a. The $60,000 distribution is labeled a return of capital because Dove has no earnings and profits. Aaron reduces the basis of his stock by $60,000 to $12,000 ($72,000 adjusted basis – $60,000 return of capital distribution).

b. As in (a.), the $80,000 distribution is treated as a return of capital because Dove has no earnings and profits. Aaron has a capital gain calculated as follows:

Amount realized $80,000
Less: Adjusted basis (72,000)
Realized gain $8,000
Recognized gain $8,000
The basis for his stock is reduced to $0.

c. Since the $60,000 distribution is a taxable dividend, Aaron’s adjusted basis for his Dover stock remains at $72,000.

p. 12-6

<table>
<thead>
<tr>
<th></th>
<th>Car</th>
<th>Clothing</th>
<th>Boat</th>
<th>Chest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount realized</td>
<td>$7,000</td>
<td>$100</td>
<td>$3,600</td>
<td>$14,000</td>
</tr>
<tr>
<td>Less: Adjusted basis</td>
<td>(19,000)</td>
<td>(600)</td>
<td>(3,500)</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Realized gain (loss)</td>
<td>($12,000)</td>
<td>($500)</td>
<td>$100</td>
<td>$4,000</td>
</tr>
<tr>
<td>Recognized gain (loss)</td>
<td>$-0-</td>
<td>$-0-</td>
<td>$100</td>
<td>$4,000</td>
</tr>
</tbody>
</table>

Gains on the sale of personal use assets are recognized, whereas losses on the sale of personal use assets are disallowed. p. 12-7

43. a. Amount realized $270,000
   Less: Adjusted basis (290,000)
   Realized loss ($20,000)
   Recognized loss $-0-

   A realized loss on the condemnation of a personal use asset is not recognized.

b. Amount realized $300,000
   Less: Adjusted basis (290,000)
   Realized gain $10,000
   Recognized gain $10,000

   A realized gain on the condemnation of a personal use asset is recognized if similar property is not acquired. However, as discussed in Chapter 15 under “Sale of a Residence—§ 121,” the recognized gain of $10,000 can be avoided if the § 121 requirements are satisfied.

c. If the house were income-producing property, the realized loss of $20,000 would be recognized.

pp. 12-3, 12-8, and Example 9

44. a. Walt must treat the purchase of the land at a $125,000 ($350,000 – $225,000) discount as a bargain purchase, since it represents compensation for services. Thus, he must include the $125,000 in his gross income.

b. Walt’s adjusted basis for the land is the fair market value of $350,000 ($225,000 cost + $125,000 increase in gross income).
June 27, 2003

Mr. Walt Barnes
100 Tower Road
San Diego, CA 92182

Dear Mr. Barnes:

You asked me to provide you with the tax consequences of the purchase of a lot from your employer, Governor’s Estates. Based on your outstanding sales performance, you were permitted to purchase a lot for $225,000 that normally would sell for $350,000. You were the only real estate agent permitted to do so.

The $125,000 discount represents compensation for services and, therefore, must be included in your gross income. Your adjusted basis for the lot is $350,000 ($225,000 cost + $125,000 amount included in gross income).

If I can be of further assistance, please inform me.

Sincerely,

Jane Reeves, CPA
Tax Partner

p. 12-9 and Example 10

45. a. Zero. No sales have occurred.

b. MDG stock basis (180 X $75) = $13,500; [$12,600 (amount realized) – $13,500 (basis)] = $900 realized loss on MDG stock.

c. GRU stock basis (90 X $300) = $27,000; [$29,700 (amount realized) – $27,000 (basis)] = $2,700 realized gain on GRU stock.

d. Second MDG sale: $13,500 (amount realized) – $11,100 (basis) = $2,400 realized gain on MDG stock.

\[
\begin{align*}
(120 X $75) & \quad 9,000 \\
(30 X $70) & \quad 2,100 \\
\text{Basis} & \quad 11,100
\end{align*}
\]

Second GRU sale: $37,500 (amount realized) – $23,625 (basis) = $13,875 realized gain on GRU stock.

\[
\begin{align*}
(60 X $300) & \quad 18,000 \\
(15 X $375) & \quad 5,625 \\
\text{Basis} & \quad 23,625
\end{align*}
\]

p. 12-9 and Example 11
46.  
   a. Frank’s adjusted basis for Bluebird Corporation stock on December 31, 2003 is $210,000 ($150,000 + $60,000).

   b. Amount realized $51,000
      Less:  Adjusted basis (60 shares X $1,500 per share) (90,000)
      Realized loss (39,000)
      Recognized loss (39,000)

   c. If Frank cannot adequately identify the shares sold, a FIFO presumption is made. Thus, the 60 shares sold are presumed to come from the 100 shares purchased on June 3, 2003 for $150,000 (i.e., $1,500 per share). Therefore, Frank has a recognized loss of $39,000 as calculated in (b) above.

p. 12-9 and Example 11

47.  
   a. Seth’s realized and recognized gain on the sale of his business is calculated as follows:

      Amount realized $900,000
      Less:  Adjusted basis (400,000)
      Realized and recognized gain $500,000

   b. Paula’s basis for each of the assets is as follows:

      Accounts receivable $ 10,000
      Notes receivable 20,000
      Machinery and equipment 100,000
      Building 300,000
      Land 350,000
      Goodwill 120,000
      $900,000

   The basis for each of the listed assets is the fair market value. Application of the residual method results in the balance of $120,000 ($900,000 – $780,000) being assigned to goodwill.

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

      June 2, 2003

Ms. Paula Andrews
300 Riverside Drive
Cincinnati, OH 45207

Dear Ms. Andrews:

I am responding to your inquiry regarding your proposal to purchase the assets of Seth’s sole proprietorship. Your $900,000 purchase price would be allocated among the assets to produce the following adjusted basis for each asset:
Accounts receivable $10,000
Notes receivable 20,000
Machinery and equipment 100,000
Building 300,000
Land 350,000
Goodwill 120,000

$900,000

The goodwill of $120,000 represents the difference between the $900,000 proposed purchase price and the total fair market value of each of the other assets.

If I can be of further assistance, please let me know.

Sincerely,

Jeff Rose, CPA
Tax Partner

p. 12-10 and Example 13

48. a. The fair market value of the nontaxable stock rights ($1,000) exceeds 15% of the fair market value of the stock ($6,000). Therefore, Paula must allocate a portion of the basis of the Yellow, Inc. stock to the stock rights received, based on their respective fair market values. The adjusted basis of the Yellow, Inc. stock decreases to $4,286 \([\frac{6,000}{7,000} \times 5,000]\).  

b. The stock rights are assigned an adjusted basis of $714 \([\frac{1,000}{7,000} \times 5,000] \text{ or } (5,000 - 4,286)\).

c. Amount realized $1,200
   Adjusted basis $486
   Realized gain $486
   Recognized gain $486

d. No gain or loss is recognized on the lapse of the stock rights. The amount of the stock basis that has been allocated to the stock rights of $714 is restored to the basis of the stock. Thus, the basis of the stock after the lapse is $5,000 ($4,286 + 714).

e. Because the fair market value of the nontaxable stock rights ($750) is less than 15% of the fair market value of the Yellow, Inc. stock ($6,000), Paula is not required to allocate part of her adjusted basis for the stock to the stock rights. Thus, there would be no effect on the adjusted basis of her stock, and the stock rights would have an adjusted basis of zero. Paula may elect to make the allocation, however. If she chooses to allocate, her adjusted basis for the Yellow, Inc. stock is $4,444 ($6,000/6,750 X $5,000). Paula’s adjusted basis for the stock rights is $556 \([\frac{750}{6,750} \times 5,000] \text{ or } (5,000 - 4,444)\).

p. 12-11 and Examples 16 and 17

49. a. Basis for gain = $30,000; $87,000 (amount realized) – $30,000 (adjusted basis) = $57,000 (realized gain).
b. Basis for gain = $10,000; $40,000 (amount realized) – $10,000 (adjusted basis) = $30,000 (realized gain).

c. Basis for loss = $12,000; $8,000 (amount realized) – $12,000 (adjusted basis) = $4,000 (realized loss).

d. $0. The proceeds of $39,000 are between the gain basis of $45,000 and the loss basis of $30,000. Therefore, neither gain nor loss is recognized.

pp. 12-12, 12-13, and Examples 18 to 20

50. a. The basis for depreciation is the donee’s gain basis of $10,000 ($18,000 cost – $8,000 accumulated depreciation).

b. $5,000 ($10,000 basis/2 years).

c. Loss basis = $6,000 (fair market value) – $5,000 (depreciation allowed) = $1,000; $900 (selling price) – $1,000 (adjusted basis) = $100 (realized loss).

d. Gain basis = $10,000 (Beth’s original gain basis) – $5,000 (depreciation for one year) = $5,000; $6,000 (selling price) – $5,000 (adjusted basis) = $1,000 (realized gain).

p. 12-15 and Example 24

51. Liz has generated zero recognized gain or loss, since the amount realized ($83,000) falls between the basis for gain ($95,000) and the basis for loss ($80,000). In this case, the gift tax paid of $9,000 does not affect basis. p. 12-13 and Example 20

52. a. Ira should not follow the friend’s advice. The sale of the stock by Ira would produce a realized and recognized gain of $5,000. If the stock is contributed to the Boy Scouts, no such recognition occurs for regular income tax purposes. The value of the stock, for purposes of calculating the amount of the charitable contribution deduction, will be $20,000 if its holding period is long-term. If the holding period is short-term, the reduction in the value of the charitable contribution required by § 170(e) from $20,000 to $15,000 [$20,000 (fair market value) – $5,000 (short-term capital gain that would result if the stock had been sold)] would produce a similar negative tax effect as the $5,000 realized and recognized gain that would result from the actual sale of the stock by Ira. Brokerage commissions and taxes would bias the form of the contribution even more in the direction of contributing the stock. p. 12-50 and Chapter 9

b. Ira should follow the friend’s advice in order to recognize a loss of $2,000 ($13,000 – $15,000). The charitable contribution in either case would be $13,000. p. 12-50 and Chapter 9

c. The choice in a. probably would be the same and the choice in b. would be the same. In making the decision in a., the critical variable is the marginal tax rate of Ira versus that of the niece (i.e., the sale should be made by the one with the lowest marginal tax rate). Normally, the niece would be expected to have the lower marginal tax rate. In b., the sale of the stock by Ira for $13,000 would result in a realized and recognized loss of $2,000, whereas the sale by the niece for $13,000 would not result in a realized loss (i.e., the niece’s loss basis for the
property received by gift would be $13,000). Any gift tax that Ira would be required to pay would not be influenced by whether he gave the stock or the cash (i.e., the gift tax is based on the fair market value of the gift). pp. 12-3, 12-12, 12-13, and 12-50

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

December 3, 2003

Mr. Ira Cook
500 Ireland Avenue
DeKalb, IL 60115

Dear Mr. Cook:

I am responding to your request concerning whether you should (1) contribute Crystal stock to the Boy Scouts, or (2) sell the stock and contribute the cash instead. Based on our telephone conversation, the following data is applicable:

   Stock purchased 6 years ago
   Adjusted basis is $15,000
   Fair market value is $20,000

You will receive more beneficial tax consequences under the first option (i.e., contribute the stock to the Boy Scouts). Under this option, you will be entitled to a charitable contribution deduction of $20,000 (i.e., the fair market value of the stock at the date of the contribution). Under the second option, you also would receive a charitable deduction of $20,000, since you would be contributing cash of $20,000 to the Boy Scouts. However, the sale of the stock would be a taxable event which would result in a recognized gain to you of $5,000 ($20,000 amount realized – $15,000 adjusted basis).

I recommend that you contribute the stock to the Boy Scouts. Should you need additional advice, please contact me.

Sincerely,

Pat Campbell, CPA
Tax Partner

p. 12-50 and Chapter 9

53. a. $2,780,000. The basis of property that is acquired from a decedent is its fair market value at the date of death. Dan’s adjusted basis is not relevant. The alternative valuation date (six months after death) and amount ($2,850,000) cannot be used in this case.

b. If the alternative valuation date can be elected by the executor, Ed’s basis for the hotel would be $2,500,000. However, the alternative valuation date cannot be elected by the executor if this amount exceeds the primary valuation ($2,780,000)
or if the election does not reduce the estate tax liability. Since the alternative valuation of $2,500,000 is less than the primary valuation of $2,780,000, it appears that the executor can elect the alternative valuation date. The key unresolved issue is whether the election would reduce the amount of the estate tax liability.

pp. 12-16 and 12-17

54. a. The inherited stock is subject to the deathbed gift rule in that the period between the date of the gift and the date of the donee’s death (i.e., Uncle George) is not greater than one year. The basis per share is $30 ($3,150/105 shares) as a result of the 5% stock dividend. Therefore, Emily’s basis for the 100 shares she inherited is $3,000 ($30 x 100 shares).

b. Since the deathbed gift rule would not be applicable, Emily’s basis for the inherited stock would be $5,500 ($55 x 100 shares).

pp. 12-11, 12-17, and Examples 14 and 30

55. a. Larry’s basis for the land is $200,000, the fair market value of the land at the date of Grace’s death. Since the land is community property, both the decedent’s share and the survivor’s share have a basis equal to the fair market value on the date of the decedent's death.

b. In this case, Larry’s basis is stepped-up only for Grace’s share and is calculated as follows:

\[
\begin{align*}
\text{Larry's one-half of the jointly held property (carryover basis of $75,000)} & \quad $75,000 \\
\text{Grace's one-half of the jointly held property (stepped up from $75,000 to $100,000 due to inclusion in her gross estate)} & \quad 100,000 \\
\text{Larry's new basis} & \quad $175,000
\end{align*}
\]

p. 12-18 and Examples 31 and 32

56. a. Amount realized $115,000
Less: Adjusted basis (120,000)
Realized loss ($ 5,000)
Less: Disallowed loss 5,000
Recognized loss $ -0-

b. Amount realized $119,000
Less: Adjusted basis (115,000)
Realized gain $ 4,000
Less: Amount of previously disallowed loss necessary to eliminate realized gain (4,000)
Recognized gain $ -0-

The remainder of the disallowed loss of $1,000 ($5,000 - $4,000) can never be deducted either by Joyce or Iris.

c. Amount realized $130,000
Less: Adjusted basis (120,000)
Realized gain $ 10,000
Recognized gain $10,000

Realized gains on related-party transactions are recognized.

d. Since Hector is not a related party, the loss disallowance provision under § 267 does not apply.

Amount realized $115,000
Less: Adjusted basis (120,000)
Realized and recognized loss ($5,000)

e. Joyce can avoid the loss disallowance provision of § 267 by selling the real estate to Hector rather than by selling it to Iris. If the real estate were real estate that the family wanted to retain, this would justify the sale to Iris. However, since Iris is going to sell the real estate eventually, this is not relevant. Therefore, Joyce should sell the real estate to Hector.

p. 12-19

57. a. Parcel A: $50,000 – $75,000 = $25,000 recognized loss.
Parcel B: $120,000 – $125,000 = $5,000 recognized loss.
Parcel C: No recognized loss under §267.

The related party rules do not apply to Doug’s father-in-law or to his partner. They do apply to his mother. See page 5-29 in Chapter 5.

b. $90,000 – $50,000 = $40,000 recognized gain.

c. $130,000 – $120,000 = $10,000 recognized gain.

d. $165,000 – $150,000 = $15,000 realized gain, less $15,000 of the previously disallowed loss = $0 recognized gain.

p. 12-19 and Example 33

58. a. Tyneka receives a stepped-up basis of $45,000 for the inherited stock received on July 15, 2003. Selling the stock for $33,000 on July 30, 2004 creates a realized loss of $12,000 ($33,000 amount realized – $45,000 adjusted basis). Because she purchases 1,000 shares of Amber within 30 days of the sale, the transaction is a wash sale and the realized loss is disallowed. Her basis for the 1,000 shares of stock purchased on August 20, 2004 is $42,000 ($30,000 cost + $12,000 disallowed loss).

b. Because Tyneka made a gift of the Amber stock to Joe within a year of his death, the inherited stock is treated as a deathbed gift. Her adjusted basis for the inherited stock received on July 15, 2003 is $35,000.

c. The tax consequences would have been the same. Tyneka has a wash sale to the extent of the 1,000 shares purchased. To avoid the limitations of the wash sale, Tyneka should not purchase substantially identical stock within the 60-day window (30 days before and 30 days after the sale date) for a wash sale.

pp. 12-15, 12-17, and 12-20
59. a. The sale of the stock will result in a $7,000 ($12,000 amount realized – $5,000 adjusted basis) capital gain to Kristy. If Kristy has capital losses, such losses can be used to offset this capital gain. Another possibility is that Kristy had ordinary losses which can be used to offset this capital gain.

b. Yes. The transaction is similar to a wash sale. However, the wash sale rules apply only to loss transactions.

c. Kristy is attempting to recognize a loss while using the sales-purchase transaction to retain her investment in the Magenta Corporation stock. The wash sale rules are applicable in this case because the stock is acquired within a 30-day period after the date of the sale. Thus, the realized loss of $3,000 ($12,000 amount realized – $15,000 adjusted basis) would not be recognized.

d. The wash sale provision will prevent Kristy from recognizing the realized loss of $3,000 ($12,000 amount realized – $15,000 adjusted basis). Kristy can avoid the wash sale provision by not acquiring substantially identical stock within 30 days before or after the date of sale. Therefore, she should not purchase shares of stock in Magenta Corporation within this time period. She could purchase Magenta Corporation stock outside this 60-day window or purchase the stock of another corporation.

p. 12-20

60. a. Jean’s adjusted basis for gain, loss, and cost recovery for the business use portion (50 percent) of the house is as follows:

<table>
<thead>
<tr>
<th></th>
<th>House</th>
<th>Land</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain basis</td>
<td>$100,000 ($200,000 X 50%)</td>
<td>$30,000 ($60,000 X 50%)</td>
</tr>
<tr>
<td>Loss basis</td>
<td>$95,000 ($190,000 X 50%)</td>
<td>$30,000 ($60,000 X 50%)</td>
</tr>
<tr>
<td>Cost recovery basis</td>
<td>$95,000 (same as loss basis)</td>
<td>$30,000 (same as loss basis)</td>
</tr>
</tbody>
</table>

b. The cost recovery for the 5-year period is calculated as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Formula</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$95,000 X 2.461%</td>
<td>$2,338</td>
</tr>
<tr>
<td>2</td>
<td>$95,000 X 2.564%</td>
<td>$2,436</td>
</tr>
<tr>
<td>3</td>
<td>$95,000 X 2.564%</td>
<td>$2,436</td>
</tr>
<tr>
<td>4</td>
<td>$95,000 X 2.564%</td>
<td>$2,436</td>
</tr>
<tr>
<td>5</td>
<td>$95,000 X 2.564 X (11.5/12)</td>
<td>$2,334</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$11,980</td>
</tr>
</tbody>
</table>

The bed and breakfast is 39-year non-residential real property.

c. The recognized gain on the sale of the business use portion of the house and land is:

<table>
<thead>
<tr>
<th></th>
<th>House (50%)</th>
<th>Land (50%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount realized</td>
<td>$150,000</td>
<td>$37,500</td>
</tr>
<tr>
<td>Less: Adjusted basis*</td>
<td>(88,020)</td>
<td>(30,000)</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$ 61,980</td>
<td>$ 7,500</td>
</tr>
<tr>
<td>Recognized gain</td>
<td>$ 61,980</td>
<td>$ 7,500</td>
</tr>
</tbody>
</table>
* Original adjusted basis for gain $100,000
Less: Cost recovery (11,980)
Adjusted basis $ 88,020

pp. 12-21, 12-22, Examples 36, 37, and Chapter 7

61. The Red Corporation stock should not be transferred to Koji as a gift. Letting Koji inherit the Red Corporation stock would enable the $650,000 appreciation \([\$700,000 \text{ (fair market value)} – \$50,000 \text{ (adjusted basis)}]\) to escape Federal income taxation (i.e., Koji would have a stepped-up basis rather than a carryover basis). The same argument could be made for the Silver Corporation stock although the appreciation is a much smaller amount ($1,000).

The Emerald Corporation stock should not be transferred to Koji as a bequest because the value decline of $150,000 \([\$50,000 \text{ (fair market value)} – \$200,000 \text{ (adjusted basis)}]\) would be permanently lost. If the Emerald Corporation stock is transferred to Koji as a gift, Koji’s gain basis will be $200,000 and his loss basis will be $50,000. Therefore, depending on the amount Koji ultimately realizes for the Emerald Corporation stock, some or all of the value decline may be lost. Perhaps Hun should be encouraged to sell the Emerald Corporation stock and give the proceeds to Koji. A recognized capital loss of $150,000 \([\$50,000 – \$200,000]\) would result. However, whether this strategy should be followed is dependent on whether Hun has other capital gains against which he can offset the capital loss, since only $3,000 of the capital loss could be offset against ordinary income each year. Hun may want to consider selling enough gain stock to offset the sale of the loss stock and transfer the cash proceeds to Koji.

62. a. Amount realized $290,000
Adjusted basis (212,000)
Realized gain $ 78,000
Recognized gain $ -0-

The exchange qualifies for § 1031 postponement treatment. pp. 12-27 and 12-28

b. Because of the postponed gain, the basis in the land is $212,000 \([\$290,000 – \$78,000]\). p. 12-31

63. a. Amount realized $16,000
Adjusted basis (19,000)
Realized loss \($ 3,000\)
Recognized loss $ -0-

The exchange qualifies for § 1031 postponement treatment. This treatment is mandatory. pp. 12-27 to 12-29

b. Because of the postponed loss, the basis in the new car is $19,000 \([\$16,000 + \$3,000]\). pp. 12-31 and 12-32

c. The exchange does not qualify for § 1031 treatment. Therefore, the realized loss of $3,000 is not recognized (loss on personal use asset) and the basis for the new car is $16,000. pp. 12-27 and 12-31
The exchange by Tanya qualifies for § 1031 like-kind exchange treatment.

\[
\begin{align*}
\text{Amount realized (}\$89,000 + \$3,000) &= \$92,000 \\
\text{Adjusted basis} &= (80,000) \\
\text{Realized gain} &= \$12,000 \\
\text{Recognized gain} &= \$3,000
\end{align*}
\]

The boot received of $3,000 triggers the recognition of $3,000 of the realized gain. Tanya’s adjusted basis for the West Coast land is calculated as follows:

\[
\begin{align*}
\text{Fair market value} &= \$89,000 \\
\text{Postponed gain (}\$12,000 – \$3,000) &= (9,000) \\
\text{Adjusted basis} &= \$80,000
\end{align*}
\]

The exchange by Lisa also qualifies for § 1031 like-kind exchange treatment.

\[
\begin{align*}
\text{Amount realized} &= \$92,000 \\
\text{Adjusted basis (}\$72,000 + \$3,000) &= (75,000) \\
\text{Realized gain} &= \$17,000 \\
\text{Recognized gain} &= \$0
\end{align*}
\]

The giving of boot does not trigger realized gain. Lisa’s adjusted basis for the East Coast land is calculated as follows:

\[
\begin{align*}
\text{Fair market value} &= \$92,000 \\
\text{Postponed gain (}\$17,000 – \$0) &= (17,000) \\
\text{Adjusted basis} &= \$75,000
\end{align*}
\]

Lisa’s recognized gain is calculated as follows:

\[
\begin{align*}
\text{Amount realized} &= \$120,000 \\
\text{Adjusted basis} &= (75,000) \\
\text{Realized gain} &= \$45,000 \\
\text{Recognized gain} &= \$45,000
\end{align*}
\]

d. Since Tanya and Lisa are related parties, Lisa’s sale of the East Coast land on September 1, 2004 (i.e., within the two-years period following the date of the like-kind exchange) results in deemed sale treatment for Tanya on September 1, 2004.

\[
\begin{align*}
\text{Amount realized} &= \$89,000 \\
\text{Adjusted basis} &= (80,000) \\
\text{Realized gain} &= \$9,000 \\
\text{Recognized gain} &= \$9,000
\end{align*}
\]

Tanya’s adjusted basis for the West Coast land is increased by the amount of the recognized gain as follows:

\[
\begin{align*}
\text{Adjusted basis before Lisa’s sale} &= \$80,000 \\
\text{Recognized gain} &= 9,000
\end{align*}
\]
Adjusted basis after Lisa’s sale  $89,000
January 15, 2003

Ms. Tanya Fletcher
The Corral
El Paso, TX 79968

Dear Ms. Fletcher:

You have asked me to provide you with the tax consequences of the January 3, 2003 land exchange with your sister, Lisa. Based on the data you provided, the tax consequences to you are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount realized</td>
<td>$92,000</td>
</tr>
<tr>
<td>Less: Adjusted basis</td>
<td>(80,000)</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$12,000</td>
</tr>
</tbody>
</table>

Recognized gain $3,000

Since the transaction qualifies for nontaxable exchange treatment as the exchange of like-kind property, only $3,000 (the $3,000 cash you received) of your potential gain of $12,000 is recognized. The adjusted basis for the land you received is $80,000 ($89,000 fair market value – $9,000 postponed gain).

Section 1031 of the Internal Revenue Code provides for the aforementioned treatment. However, since the exchange was with a related party (i.e., Lisa), the Code provides that neither you nor Lisa should dispose of the land you received in the exchange prior to two years after the date of the exchange (i.e., January 4, 2005). Such a disposition by either of you would make the exchange transaction on January 3, 2003 taxable for both Lisa and you as of the date of the disposition. I suggest that you communicate this information to Lisa.

If I can be of further assistance, please let me know.

Sincerely,

Margaret Adams, CPA
Tax Partner

65.  

a.  

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount realized</td>
<td>$9,000</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>(7,000)</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

Recognized gain $2,000

Sarah’s exchange qualifies for 1031 like-kind exchange treatment. However, the receipt of boot (the equipment) of $4,000 causes Sarah’s realized gain to be
recognized. Her adjusted basis for the gray bus is its fair market value of $5,000, and her adjusted basis for the equipment is its fair market value of $4,000.

b. Amount realized $9,000
Adjusted basis ($1,000 + $2,000) (3,000)
Realized gain $6,000
Recognized gain $2,000

Tyler’s exchange also qualifies for §1031 like-kind exchange treatment. The giving of boot (the equipment) typically does not trigger the recognition of realized gain. However, since the equipment is appreciated boot, the amount of the appreciation is recognized. His adjusted basis for the yellow bus is $5,000 ($9,000 fair market value – $4,000 postponed gain).

pp. 12-28 to 12-31

66. a. Amount realized ($15,000 + $2,000) $17,000
Adjusted basis (20,000) (20,000)
Realized loss ($ 3,000) ($ 3,000)
Recognized loss ($ -0-) ($ -0-)

FMV of office equipment $15,000
+ Postponed loss 3,000
Adjusted basis $18,000

Even though boot of $2,000 is received, there is no recognized gain because the exchange produces a realized loss.

b. Laura’s holding period for the new office equipment begins in May 2000, the purchase date of the original office equipment.

c. Amount realized $50,000
Adjusted basis ($12,000 + $2,000) (14,000)
Realized gain ($36,000) ($36,000)

Recognized gain $ -0-

FMV of parking garage $50,000
– Postponed gain (36,000)
Adjusted basis of parking garage $14,000

The giving of boot (i.e., cash of $2,000) does not trigger the recognition of the realized gain.

d. Laura’s holding period for the parking garage begins in April 1995, the purchase date of the land.

e. By selling the office equipment to one party and by purchasing the other office equipment from a different party, Laura could recognize the realized loss of $3,000. Her adjusted basis for the replacement office equipment would be the purchase price of $15,000.
67. a. Amount realized $30,000
   Adjusted basis ($26,000 + $18,000) (44,000)
   Realized loss (14,000)

   Recognized loss ($-0-)

   Section 1031 does not apply to the exchange because the personal use car is neither productive use nor investment property. In addition, the realized loss of $14,000 is not recognized because losses on personal use property are not recognized. p. 12-27

b. Susan’s basis for the new car is its cost of $30,000 ($12,000 fair market value of used car + $18,000 cash). p. 12-31

c. Susan’s holding period for the new car begins on the date of purchase. p. 12-32

68. a. Amount realized ($175,000 + $100,000) $275,000
   Adjusted basis (125,000)
   Realized gain $150,000

   Recognized gain $100,000

   The exchange qualifies for like-kind exchange treatment. However, since boot (i.e., the stock) is received, the realized gain is recognized to the extent of the boot received. As the boot received of $100,000 is less than the realized gain of $150,000, only $100,000 of the $150,000 realized gain is recognized.

c. The basis of the land is $125,000 (fair market value of $175,000 minus postponed gain of $50,000). The basis of the stock is the fair market value of $100,000.

d. Amount realized ($100,000 + $175,000) $275,000
   Adjusted basis (125,000)
   Realized gain $150,000

   Recognized gain $150,000

   Since boot (i.e., the stock) is received, the realized gain is recognized to the extent of the boot received. The boot received of $175,000 exceeds the realized gain of $150,000. So the recognized gain is $150,000. The basis for the land and the stock received by Tom is the fair market value ($100,000 for the land and $175,000 for the stock).

69. a. Amount realized $175,000
   Adjusted basis (35,000)
   Realized gain $140,000

   Recognized gain $-0-
From the perspective of Ed, the exchange qualifies for § 1031 postponement treatment.

Basis for office building ($175,000 – $140,000 postponed gain) $ 35,000

b. Amount realized $175,000
Adjusted basis (175,000)
Realized gain $ -0-

Recognized gain $ -0-

Polly does not qualify for § 1031 treatment since the office building she exchanged was not held for productive use or investment (i.e., it was held for resale). However, since Polly has no realized gain, she does not need the protection of § 1031.

Basis for the land $175,000

70. a. Amount realized $15,000
Adjusted basis (12,000)
Realized gain $ 3,000

Recognized gain $ 3,000

b. The basis for Machine B is its cost of $15,000.

c. Such an exchange would have resulted in the realized gain being postponed under § 1031. However, this would cause Steve’s basis in the machine received to be $12,000 ($12,000 adjusted basis + $0 gain recognized + $0 boot given or $15,000 fair market value – $3,000 postponed gain). Because the sale transaction is fully taxable, the recognition of gain permits Steve to have a higher basis for the new machine. In addition, Steve may have some losses with which he can offset the $3,000 recognized gain.

d. Amount realized $12,000
Adjusted basis (15,000)
Realized loss $ 3,000

Recognized loss $ 3,000

The basis for Machine B is its cost of $12,000. Avoiding § 1031 treatment enables Steve to recognize the $3,000 realized loss.

pp. 12-28 to 12-31

71. a. The exchange qualifies as a like-kind exchange for both Tom and Frank.

<table>
<thead>
<tr>
<th></th>
<th>Frank</th>
<th>Tom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount realized</td>
<td>$92,000</td>
<td>$92,000</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>(64,000)</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$28,000</td>
<td>$32,000</td>
</tr>
<tr>
<td>Recognized gain</td>
<td>$ -0-</td>
<td>$12,000</td>
</tr>
</tbody>
</table>
Frank’s adjusted basis of $64,000 consists of the $52,000 adjusted basis for the property transferred increased by the $12,000 mortgage he assumed on the property received from Tom. Tom’s amount realized of $92,000 consists of the $80,000 fair market value of the property received increased by his $12,000 mortgage assumed (boot received) by Frank. The $12,000 boot received triggers the recognition of $12,000 of Tom’s realized gain.

<table>
<thead>
<tr>
<th></th>
<th>Frank</th>
<th>Tom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair market value</td>
<td>$92,000</td>
<td>$80,000</td>
</tr>
<tr>
<td>Less: Postponed gain</td>
<td>(28,000)</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>$64,000</td>
<td>$60,000</td>
</tr>
</tbody>
</table>

The alternative would produce the following tax consequences for Tom:

<table>
<thead>
<tr>
<th></th>
<th>Amount realized ($80,000 + $12,000)</th>
<th>Adjusted basis</th>
<th>Realized gain</th>
<th>Recognized gain</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$92,000</td>
<td>(60,000)</td>
<td>$32,000</td>
<td>$12,000</td>
</tr>
</tbody>
</table>

Since the cash is treated as boot, the recognized gain of $12,000 would be the same as in (a). Tom’s adjusted basis for the realty received of $60,000 would be the same as in (b). Therefore, the tax consequences to Tom under the alternative proposal are the same as under the original proposal.
e. Realized gain = $2,000.
   Recognized gain = $1,000.
   Postponed gain = $1,000.
   New basis = $10,000 ($11,000 fair market value of new asset – $1,000 postponed gain).

f. Realized loss = $2,000.
   Recognized loss = $0.
   Postponed loss = $2,000
   New basis = $10,000 ($8,000 fair market value of new asset + $2,000 postponed loss).

Example 50

73. a. Amount realized
    
    [$150,000 (cash) + $975,000 (office building)
     + $240,000 (mortgage)]
    $1,365,000
    Adjusted basis of apartment house given up
    (950,000)
    Realized gain
    $415,000

   b. Recognized gain = $390,000
      [$150,000 (cash) + $240,000 (mortgage assumed by Dave is treated as boot received);
      lower of boot received of $390,000 or realized gain of $415,000].
      Postponed gain = $25,000.

   c. New basis = $950,000
      [$975,000 (fair market value of office building received) – $25,000 (postponed gain)].

Example 51

74. Amount realized $128,000
    Adjusted basis (140,000)
    Realized loss ($12,000)
    Recognized loss ($12,000)

Monica has a recognized loss of $12,000 on the involuntary conversion. A realized loss
on the involuntary conversion of business property is recognized. Her adjusted basis for
the new roadside vegetable stand is her cost of $158,000.  pp. 12-34 and 12-39

75. a. Amount realized
    $10,000
    Adjusted basis [(5 acres/100 acres) X $100,000)]
    (5,000)
    Realized gain $5,000
    Recognized gain $5,000

Since Albert did not acquire qualifying replacement property, the $5,000 realized
gain is recognized.

b. The severance award reduces the basis of Albert’s remaining property to $89,000.

Adjusted basis of remaining land ($100,000 – $5,000) $95,000
Less: severance award (6,000)
Adjusted basis $89,000
76. a. Since Frank is an owner-investor, the taxpayer use test applies. Replacing the warehouse that is rented to various tenants with a shopping mall that is rented to various tenants in a different location qualifies as replacement property.

b. Since Ivan is an owner-user, the functional use test applies. Replacing the warehouse used in his business with another warehouse in a different state which is to be used in his business qualifies as replacement property under the functional use test.

c. Since Ridge is an owner-user, the functional use test applies. Purchasing another residence to replace the condemned residence qualifies as replacement property under the functional use test.

d. Since Juanita was an owner-user of the building, the functional use test applies. Thus, Juanita’s use of the replacement property and of the involuntarily converted property must be the same. Since her use of the four-unit apartment building is different from the use of the building in her retail business, the apartment building does not qualify as replacement property.

e. Since Susan and Rick are owner-users, the functional use test applies. The rental duplex does not qualify as replacement property under this test.

77. a. The earliest date for the replacement of condemned realty used in a business is the date of the threat or imminence of requisition or condemnation of the property. Therefore, the earliest Jason can acquire qualifying replacement property is March 4, 2003.

b. Jason’s realized gain is $62,000 ($212,000 condemnation proceeds – $150,000 adjusted basis). His recognized gain is $12,000 because only $200,000 (i.e., deficiency of $12,000) of the condemnation proceeds are reinvested in the new land and building.

c. The adjusted basis of Jason’s new land and building is $150,000 [$200,000 cost – $50,000 postponed gain ($62,000 realized gain – $12,000 recognized gain)].

d. Amount realized $212,000
   Adjusted basis (150,000)
   Realized gain $  62,000
   Recognized gain $  62,000

Since Jason chose not to elect § 1033 postponement of gain treatment, his realized gain of $62,000 is recognized. The adjusted basis of his new land and building is the cost of $200,000.

e. Jason’s realized gain of $62,000 is recognized since he did not acquire qualifying replacement property.
78. a. Postponed gain = $0. The $30,000 realized gain is recognized because the amount that the taxpayer reinvested is only $110,000. Basis = $110,000 – $0 = $110,000.

b. Postponed loss = $0. The condemnation loss of $25,000 is recognized. Basis = $175,000 + $0 = $175,000.

c. Postponed gain = $100,000. Basis = $450,000 – $100,000 = $350,000.

d. Postponed loss = $0. The $2,000 casualty loss is recognized, less the $100 floor = $1,900. The $1,900 must be reduced further by 10% of adjusted gross income. This 10% floor is applied to the total of casualty losses that are deductible for the taxable year rather than to each casualty. Basis = $17,000 + $0 = $17,000.

e. Postponed gain = $60,000. Of the realized gain of $80,000, $20,000 is recognized because of the reinvestment deficiency of $20,000. Basis = $220,000 – $60,000 = $160,000.

f. Postponed gain = $1,000. Basis = $19,000 – $1,000 = $18,000.

g. Postponed loss = $0. The $2,000 loss on the condemnation of personal use property is nondeductible. Basis = $26,000 + $0 = $26,000.

h. Postponed gain = $50,000. Basis = $200,000 – $50,000 = $150,000.

79. a. In order to minimize her tax liability resulting from the receipt of the insurance proceeds, Wanda should choose the first option. Her recognized gain under § 1033 would be only $10,000.

| Amount realized | $230,000 |
| Adjusted basis  | (180,000) |
| Realized gain   | $ 50,000 |

| Required reinvestment | $230,000 |
| Actual reinvestment   | (220,000) |
| Deficiency            | $ 10,000 |

Her recognized gain is $10,000, the smaller of the realized gain of $50,000 and the reinvestment deficiency of $10,000.

If Wanda were to use the $230,000 to purchase a new home, her recognized gain would be $50,000. The new home would not be qualified replacement property under § 1033.

b. The replacement deadline is two years after the close of the taxable year in which any gain is realized. For Wanda, gain realization does not occur until 2004. Therefore, since Wanda is a calendar year taxpayer, the latest replacement date is December 31, 2006. To postpone all of the realized gain of $50,000, she needs to reinvest the entire proceeds of $230,000.

c. Section 1033(g) provides that if the form of the involuntary conversion is the condemnation of real property used in a trade or business or held for investment,
the replacement deadline is extended for an additional year. Thus, the latest replacement date is December 31, 2007.

pp. 12-34, 12-37, and 12-38

80. a. Amount realized ($297,000 – $20,000) $277,000
   Adjusted basis (110,000) 
   Realized gain $167,000

b. Realized gain $167,000
   § 121 exclusion (-0-)
   Recognized gain $167,000

In order to be eligible for the § 121 exclusion, Kelly needed to have owned and occupied the house as her principal residence for at least two years on the date of sale (January 15, 2003). Since she does not satisfy this requirement, the § 121 exclusion is not available.

c. Kelly’s basis for her new house is $300,000, the summation of the cost of $280,000 and the capital improvement of $20,000.

d. If Kelly had delayed the sale of her principal residence until February 15, 2003, she would have met the 2-year ownership and use requirement and would have been eligible for the § 121 exclusion. In that case, her recognized gain would have been $0 ($167,000 realized – $167,000 § 121 exclusion). Since § 121 provides for exclusion treatment rather than postponement treatment, Kelly’s basis for her new home still is $300,000 ($280,000 + $20,000).

p. 12-41

81. a. Amount realized $230,000
   Adjusted basis (175,000)
   Realized gain $ 55,000
   § 121 exclusion (55,000)
   Recognized gain $ -0-

b. Amount realized $240,000
   Adjusted basis (175,000)
   Realized gain $ 65,000

Recognized gain $ 65,000

Since Tina does not satisfy the at least two years out of five years ownership and occupancy requirement, she is not eligible for the § 121 exclusion. Thus, her realized gain of $65,000 is recognized.

c. Tina should accept the $230,000 offer. The recognized gain on the $240,000 offer produces a tax cost of $13,000 ($65,000 X 20% capital gain rate). Thus, her cash flow from the $240,000 offer is only $227,000 ($240,000 – $13,000) whereas her cash flow from the $230,000 offer is $230,000.

p. 12-41
82.  

a. Amount realized $375,000 ($390,000 – $15,000)
Realized gain $320,000 ($375,000 – $55,000)
§ 121 exclusion $250,000
Recognized gain $70,000 ($320,000 – $250,000)
Basis of new residence None

b. Amount realized $261,000 ($270,000 – $9,000)
Realized gain $141,000 ($261,000 – $120,000)
§ 121 exclusion $141,000
Recognized gain $-0- ($141,000 – $141,000)
Basis of new residence $260,000

c. Amount realized $448,000 ($465,000 – $17,000)
Realized gain $413,000 ($448,000 – $35,000)
§ 121 exclusion $250,000
Recognized gain $163,000 ($413,000 – $250,000)
Basis of new residence $400,000

d. Amount realized $64,000 ($70,000 – $6,000)
Realized loss $1,000 ($64,000 – $65,000)
Recognized loss $-0- (Realized loss on the sale of a personal use asset is never deductible.)
Basis of new residence $80,000

e. Amount realized $146,000 ($150,000 – $4,000)
Realized gain $66,000 ($146,000 – $80,000)
§ 121 exclusion $66,000
Recognized gain $-0- ($66,000 – $66,000)
Basis for new residence $120,000

pp. 12-44 and 12-45

83.  

a. Realized gain $340,000
§ 121 exclusion (340,000)
Recognized gain $-0-

Pedro and Maria are eligible for a maximum § 121 exclusion of $500,000. One spouse, Pedro, meets the ownership requirement and both spouses meet the use requirement.

b. Realized gain $340,000
§ 121 exclusion (250,000)
Recognized gain to Pedro $90,000

Pedro is eligible for a maximum § 121 exclusion of $250,000 on his separate return. Since Maria has no ownership interest in the residence, she does not report anything on her separate return regarding the sale of the residence.

c. Realized gain $550,000
§ 121 exclusion (500,000)
Recognized gain $50,000
Pedro and Maria are eligible for a maximum exclusion of $500,000.

d.  Realized gain  $550,000  
    § 121 exclusion  (250,000)  
    Recognized gain  $300,000

Pedro is eligible for a maximum § 121 exclusion of $250,000. Since Maria has no ownership interest in the residence, she does not report anything on her separate return regarding the sale of the residence.

e.  Only Pedro is eligible for the § 121 exclusion on the sale of his house. While only Pedro needs to meet the ownership requirement, both Pedro and Maria need to meet the use requirement to be eligible for the $500,000 exclusion amount.

Realized gain  $340,000  
    § 121 exclusion  (250,000)  
    Recognized gain  $  90,000

pp. 12-42 to 12-44

84.  a.  

<table>
<thead>
<tr>
<th>Selling price</th>
<th>Meg</th>
<th>Walt</th>
</tr>
</thead>
<tbody>
<tr>
<td>$450,000</td>
<td>$190,000</td>
<td></td>
</tr>
<tr>
<td>Selling expenses</td>
<td>(40,000)</td>
<td>(19,000)</td>
</tr>
<tr>
<td>Amount realized</td>
<td>$410,000</td>
<td>$171,000</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>(75,000)</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$335,000</td>
<td>$111,000</td>
</tr>
<tr>
<td>§ 121 exclusion</td>
<td>(250,000)</td>
<td>(111,000)</td>
</tr>
<tr>
<td>Recognized gain</td>
<td>$  85,000</td>
<td>$ -0-</td>
</tr>
</tbody>
</table>

Meg and Walt each have owned and occupied their respective residences for at least two years during the 5-year period preceding the date of sale. Thus, each qualifies for the § 121 exclusion on the sale of their respective residences.

b.  Assuming they sell them in the same tax year, the tax consequences will be the same as in (a). However, if they are willing to live in Meg’s residence for an additional two years after Walt’s residence is sold and they file a joint return in the year of sale of Meg’s residence, they could exclude up to $500,000 of realized gain on the sale of Meg’s house. This sale should occur no sooner than two years after the sale of Walt’s residence. All of the realized gain on the sale of Walt’s residence is excluded because Walt’s available § 121 exclusion of $250,000 far exceeds his realized gain.

c.  Regardless of the form of ownership of the new residence, the adjusted basis is its cost of $400,000. The § 121 exclusion is not affected by whether a replacement residence is acquired. Likewise, if they satisfy the § 121 qualification requirements on the subsequent sale of the new residence, they can exclude up to $500,000 of the realized gain if they file a joint return.

d.  Delaying the marriage is a personal decision. However, if they are willing to follow the advice in (b) of living in Meg’s house for an additional two years, they could reduce Meg’s recognized gain of $85,000 to $0.

pp. 12-42 to 12-44
October 21, 2003

Ms. Nell Sanders
100 Oak Avenue
Billings, Montana 59101

Dear Nell:

I am responding to your inquiry regarding the tax consequences of the sale of the residence owned by Nina, Nora, and you. Since each of you has owned and lived in the house for at least 2 of the past 5 years, each of you qualifies for § 121 exclusion treatment. According to our conversation, none of you intend to acquire a replacement residence. If any of you should do so, your adjusted basis for the new residence will be its cost. Therefore, each of you will report the following on your 2003 Federal income tax return:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount realized</td>
<td>$225,000</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$205,000</td>
</tr>
<tr>
<td>§ 121 exclusion</td>
<td>(205,000)</td>
</tr>
<tr>
<td>Recognized gain</td>
<td>$ 0</td>
</tr>
</tbody>
</table>

Under this provision, each of you qualifies for a maximum exclusion of realized gain of $250,000.

Sincerely,

Louis Jordan, CPA

b. TAX FILE MEMORANDUM

DATE: October 21, 2003

FROM: Louis Jordan

SUBJECT: Nell Sanders Sale of Residence

Nell Sanders contacted us on behalf of herself and her sisters Nina and Nora. They recently sold the house in which they have lived for the past 20 years. The residence was inherited from their parents 20 years ago. At that time, the house had a fair market value of $60,000. Each sister had a one-third ownership interest in the house.

During the period they owned and occupied the house, the sisters incurred various expenditures for repairs and maintenance. However, during this period, they made no capital expenditures.
They recently sold the house for $750,000. Selling expenses and legal fees were $75,000. They do not intend to acquire a replacement residence.

Each of the sisters qualifies for exclusion treatment under § 121. All three satisfy the at least two years ownership and occupancy requirements. Since the realized gain for each sister is less than the $250,000 exclusion available to each, the recognized gain for each sister is $0. The following tax consequences would then be reported on the 2003 Federal income tax return of each sister.

| Amount realized ($250,000 sales price – $25,000 selling expenses and legal fees) | $225,000 |
| Adjusted basis | (20,000) |
| Realized gain | $205,000 |
| § 121 exclusion | (205,000) |
| Recognized gain | $ 0 |

pp. 12-42 and 12-43

86. a. The form of the transaction is an involuntary conversion. However, since the property that is involuntarily converted is Sam’s principal residence, the transaction is treated under the sale of residence provisions. Sam satisfies the at least two years ownership and occupancy requirement. He is therefore eligible for the § 121 exclusion. His recognized gain is calculated as follows:

| Amount realized | $350,000 |
| Adjusted basis | (170,000) |
| Realized gain | $180,000 |
| § 121 exclusion | (180,000) |
| Recognized gain | $ 0 |

Since the realized gain is excluded rather than postponed, it is not necessary for Sam to acquire a replacement residence. If he should do so, his adjusted basis will be the cost of the new residence.

b. Sam probably should not acquire a replacement residence since he will be retiring and moving in about two years. This will avoid the necessity of selling another house. However, if Sam expects real estate values to appreciate substantially during the two-year period, he may want to purchase another residence. If he does, he needs to own and occupy it as his principal residence for at least two years so he can once again qualify for the § 121 exclusion.

c. Sam can initially reduce his realized gain to $180,000 through the use of the § 121 exclusion.

| Amount realized | $600,000 |
| Adjusted basis | (170,000) |
| Realized gain | $430,000 |
| § 121 exclusion | (250,000) |
| Recognized gain after § 121 exclusion | $180,000 |

If Sam does not acquire another residence by December 31, 2005 (i.e., two years after December 31, 2003), his recognized gain is $180,000. However, Sam can postpone the recognition of the $180,000 realized gain if he elects § 1033.
postponement treatment and acquires another residence costing at least $350,000 by December 31, 2005.

Required reinvestment under § 1033:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount realized</td>
<td>$600,000</td>
</tr>
<tr>
<td>§ 121 exclusion</td>
<td>(250,000)</td>
</tr>
<tr>
<td>Required reinvestment</td>
<td>$350,000</td>
</tr>
</tbody>
</table>

In this case, Sam’s adjusted basis for his new residence would be $170,000.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>$350,000</td>
</tr>
<tr>
<td>Postponed gain</td>
<td>(180,000)</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>$170,000</td>
</tr>
</tbody>
</table>

pp. 12-44, 12-45, and 12-47

87.  

a.  

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount realized</td>
<td>$80,000</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>(35,000)</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$45,000</td>
</tr>
</tbody>
</table>

Recognized gain  

Realized gains or realized losses on property transactions between spouses are not recognized.

b.  

Sal’s adjusted basis for the Peach stock is a carryover basis of $35,000 (i.e., for basis purposes, the transaction is treated as a gift).

c.  

The tax consequences would be the same as in (a) and (b) if Ruth had made a gift of the stock to Sal. Since the sale form and the gift form produce the same tax consequences, the key is whether Sal wants to transfer the $80,000 to Ruth.

p. 12-47

CUMULATIVE PROBLEMS

88.  

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albert’s retirement income (Note 1)</td>
<td>$3,600</td>
</tr>
<tr>
<td>Carol’s retirement income (Note 2)</td>
<td>6,960</td>
</tr>
<tr>
<td>Albert’s bonus (Note 3)</td>
<td>5,000</td>
</tr>
<tr>
<td>Gambling income (Note 4)</td>
<td>26,000</td>
</tr>
<tr>
<td>Social Security benefits (Note 5)</td>
<td>1,643</td>
</tr>
<tr>
<td>Gross income</td>
<td>$43,203</td>
</tr>
<tr>
<td>Less: Alimony paid</td>
<td>(11,250)</td>
</tr>
<tr>
<td>Net long-term capital loss (Notes 6, 7, and 8) ($175 - $700)</td>
<td>(525)</td>
</tr>
<tr>
<td>Adjusted gross income</td>
<td>$31,428</td>
</tr>
<tr>
<td>Less: Standard deductions ($7,850 + $900 + $900)</td>
<td>(9,650)</td>
</tr>
<tr>
<td>Personal exemptions (1 each for Albert and Carol)</td>
<td>(6,000)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$15,778</td>
</tr>
</tbody>
</table>

Tax on $15,778 from 2002 Tax Table (Note 11)  

Less: Prepayments and credits  

$1,766
Estimated tax paid $3,100
Tax credit for the elderly (Note 12) 0 (3,100)
Income tax payable (or refund due) for 2002 ($ 1,334)

See the tax return solution beginning on p. 12-49 of the Solutions Manual.

Notes

(1) Since Albert’s distribution is from a qualified retirement plan, the simplified method is used.

\[
\frac{\text{Albert’s investment in the plan}}{\text{Number of anticipated payments}} = \frac{63,000}{210} = 300 \text{ exclusion per month}
\]

Annual payments ($600 X 12) $7,200
Exclusion ($300 X 12) (3,600)
Inclusion in gross income $3,600

(2) Since Carol’s distribution is from a qualified pension plan, the simplified method is used.

\[
\frac{\text{Carol’s investment in the plan}}{\text{Number of anticipated payments}} = \frac{57,200}{260} = 220 \text{ exclusion per month}
\]

Annual payments ($800 X 12) $9,600
Exclusion ($220 X 12) (2,640)
Inclusion in gross income $6,960

(3) Albert is a cash basis taxpayer. Therefore, he includes the $5,000 bonus in his gross income in 2002.

(4) Carol’s net winnings of $1,000 from the casino are included in gross income. Likewise, Albert’s winnings from the lottery of $25,000 are included in gross income. Note that the cost of the lottery ticket would be an itemized deduction if they itemized deductions.

(5) The amount of Social Security benefits that is includible in gross income is calculated as follows:

\[
\text{Lesser of: } .50(11,000) = 5,500 \text{ or } .50[29,785 + .50(11,000) – 32,000] = 1,643
\]

(6) The sale of the stock that Albert and Carol had received as a stock dividend is treated as follows:

\[
\begin{align*}
\text{Amount realized from the sale (6 shares } \times \text{ $40)} & \quad 240 \\
\text{Less: Basis of stock sold } & \text{[ } 720 \text{ (original cost)} / 66 \text{ \ (number of shares held) } \times \ 6 \ (\text{number of shares sold}) & \quad 65 \\
\text{Long-term capital gain (holding period “tacks”) } & \quad 175 
\end{align*}
\]

(7) The loss of $12,000 ($5,000 – $17,000) on the sale of Carol’s personal use car is not deductible.

(8) The sale of stock that Albert and Carol had received as a gift is treated as follows:
Amount realized from the sale (100 X $15) $1,500
Less: Basis for loss (the fair market value of the stock on the date of the gift, 100 X $22 per share) (2,200)
Long-term capital loss ($700)

(9) Carol’s inheritance of her mother’s personal residence is excludible from gross income. Gain or loss is not recognized until Carol sells the house.

(10) The alimony of $11,250 that Albert paid to Nancy is a deduction for AGI.

(11) The tax liability from the tax table is $1,766.

(12) In computing the tax credit for the elderly, start with the statutory maximum amount of $7,500 (married taxpayers age 65 or older) and deduct $9,357 (nontaxable part of Social Security benefits). Since Albert and Carol’s 2002 adjusted gross income is greater than $10,000, the base must be reduced by an additional $10,714 [50% X ($31,428 – $10,000)]. Since reducing the $7,500 by $20,071 ($9,357 + $10,714) produces a negative amount, the tax credit for the elderly is $0.

89. Part 1 — Tax Computation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business income (Note 1)</td>
<td>$240,000</td>
</tr>
<tr>
<td>Alimony ($1,400 X 12)</td>
<td>16,800</td>
</tr>
<tr>
<td>Deductions for adjusted gross income</td>
<td></td>
</tr>
<tr>
<td>Business expenses excluding home office</td>
<td>$120,800</td>
</tr>
<tr>
<td>Home office ($1,230 + $705) (Note 2)</td>
<td>1,935</td>
</tr>
<tr>
<td>Self-employment tax ($13,929 X 50%) (Note 6)</td>
<td>6,965</td>
</tr>
<tr>
<td>Adjusted gross income</td>
<td>$127,100</td>
</tr>
<tr>
<td>Less: Itemized deductions (Note 3)</td>
<td>(19,400)</td>
</tr>
<tr>
<td>Personal exemption and dependency exemptions (2 X $3,050) (Note 4)</td>
<td>(6,100)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$101,600</td>
</tr>
</tbody>
</table>

Income tax computation:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on $101,600 (Head of household) (Note 5)</td>
<td>$22,467</td>
</tr>
<tr>
<td>Self-employment tax (Note 6)</td>
<td>13,929</td>
</tr>
<tr>
<td>Tax liability before prepayments and credits</td>
<td>$36,396</td>
</tr>
<tr>
<td>Less: Estimated tax payments</td>
<td>(38,000)</td>
</tr>
<tr>
<td>Net tax payable (or refund) for 2003</td>
<td>($1,604)</td>
</tr>
</tbody>
</table>

Notes

(1) Since Tammy is a cash method taxpayer, the appropriate amount of revenue to report is $240,000.

(2) Tammy’s home office qualifies for deduction under § 280A(c)(1)(A) as her principal place of business. One-tenth of the expenses paid associated with the home office are deductible.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilities</td>
<td>$360</td>
</tr>
<tr>
<td>Insurance</td>
<td>100</td>
</tr>
<tr>
<td>Property taxes</td>
<td>500</td>
</tr>
<tr>
<td>Repairs</td>
<td>270</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,230</strong></td>
</tr>
</tbody>
</table>
In addition, $705 of cost recovery on the home office is deductible. To calculate the cost recovery, Tammy’s basis for the house must be determined. Her original basis for the house is the $275,000 cost. The cost recovery for 2003 for the home office is $705 ($275,000 X 1/10 X 2.564%). The cost recovery deduction is calculated using Table 7-9 for 39 year nonresidential real property.

(3) Itemized deductions (excluding those associated with the house) $14,900
Itemized deductions associated with the house:
   Property taxes ($5,000 X 9/10) 4,500
Total itemized deductions $19,400

(4) Tammy receives a personal exemption deduction for herself. Tammy, the custodial parent, is eligible to take the dependency deduction for her child. However, Tammy has waived the dependency deduction for Thomas for 2003 to her former spouse by providing him with a signed Form 8332. Tammy can claim a dependency deduction for her mother under a multiple support agreement. For a multiple support agreement to be effective, Tammy and her brother and sister would need to provide greater than 50% of their mother’s support. Together they provided 56% ($6,700/$11,900) of their mother’s support, and each of them provided over 10%. Since Bob and Susan are willing to sign a multiple support waiver (Form 2120), Tammy can take a dependency deduction for her mother.

(5) Tammy qualifies for head of household status because she provides over 50% of the household costs for her child. Since the child is unmarried, it is not necessary that the child be Tammy’s dependent (even though he could be in this case).

(6) Computation of the self-employment tax

Step 1 Net earnings from self-employment
   ($240,000 – $120,800 – $1,935) $117,265

Step 2 Multiple Step 1 by 92.35% $108,294
Step 3 If the amount in Step 2 is more than $87,000, multiply the excess over $87,000 by 2.9% and add $13,311.
   This is the self-employment tax. $ 13,929

Part 2 — Tax Planning

Decrease in alimony received ($16,800 X 25%) $ 4,200
Less: Tax liability reduction if not alimony
   Alimony presently received $16,800
   Tammy’s marginal tax rate X 29% (4,872)
Cash flow benefit to Tammy of accepting former husband’s proposal $ 672
October 3, 2003

Ms. Tammy Walker
101 Glass Road
Richmond, VA 23236

Dear Ms. Walker:

In response to your inquiry regarding the tax consequences of modifying the amount of the alimony you receive, the facts and related tax consequences are presented below.

Presently, you are receiving alimony payments of $1,400 per month. These payments qualify as alimony for Federal tax purposes under Section 71 of the Internal Revenue Code of 1986. Therefore, the payments are deductible to your former husband under Section 215 and are includible in your gross income under Section 71. Since your marginal tax rate for 2004 is projected to be 29%, the alimony payments of $16,800 annually will increase your 2004 Federal tax liability by $4,872 ($16,800 X 29%). Therefore, your net cash flow from the alimony in 2004 would be $11,928 ($16,800 alimony – $4,872 tax liability).

Under the reduction proposed by your former husband, the payment you receive each month will be reduced from $1,400 to $1,050. In exchange for the reduction of $350 per month, he will agree that the payments are not alimony for Federal tax purposes as provided in Section 71(b)(1)(B). Therefore, the payments will not be deductible by him or includible in your gross income. Your net cash flow from these payments will be $12,600 ($12,600 payments – $0 tax liability).

Based on the above analysis, I recommend that you accept the proposal to reduce the payments. Doing so will increase your net cash flow by $672 each year.

| Net cash flow under proposal          | $12,600 |
| Net cash flow presently              | (11,928) |
| Increase in net cash flow            | $ 672   |

If our firm can be of additional assistance, please let me know.

Sincerely,

John J. Jones, CPA
Partner
TAX FILE MEMORANDUM

DATE: October 3, 2003

FROM: John J. Jones

SUBJECT: Proposed Change in Alimony Payments for Tammy Walker

Tammy Walker presently receives alimony payments of $1,400 per month. The payments are classified as alimony under § 71. Her former husband has proposed reducing the payments from $1,400 per month to $1,050 per month. In exchange for the $350 per month reduction, he will agree that the payments are not alimony for Federal tax purposes as provided in § 71(b)(1)(B).

Tammy is a self-employed accountant whose marginal tax rate for 2004 will be 29%. Based on discussions with Tammy and the analysis of her Federal tax return, it appears that her marginal tax rate will remain constant or increase.

The net cash flow consequences of the present alimony agreement and the proposed revision are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed revision ($12,600 – $0)</td>
<td>$12,600</td>
</tr>
<tr>
<td>Present [$16,800 – (29% X $16,800)]</td>
<td>(11,928)</td>
</tr>
<tr>
<td>Increase in net cash flow</td>
<td>$ 672</td>
</tr>
</tbody>
</table>

Under the present agreement, the payment is alimony that must be included in Tammy’s gross income. Under the revision, the payment is excludible. Thus, the proposed revision will increase Tammy’s net cash flow by $672 annually.

90. Business income (Note 1) $93,000
Dividend income ($9,000 + $4,000) 13,000
Interest income ($6,000 + $1,500) (Note 2) 7,500
Lottery winnings 8,500
Capital loss (Note 3) (3,000)
Alimony payments (Note 4) (35,000)
Self-employment tax (Note 5) (6,509)
Self-employed health insurance (Note 6) (2,100)
Adjusted gross income $75,391
Less: Itemized deductions (Note 7) (32,446)
Personal and dependency exemption ($3,000 X 2) (Note 8) (6,000)
Taxable income $36,945

Income tax computation:
Tax on taxable income of $36,945 (Note 9) $ 6,316
Self-employment tax (Note 5) 13,018
Tax liability before prepayments and credits $19,334
Less: Estimated tax payments (20,000)
Child tax credit (Note 10) (550)
Net tax payable (or refund) for 2002 $(1,216)

See the tax return solution beginning on p. 12-53 of the Solutions Manual.
Notes

(1) The net income of Arnold’s sole proprietorship is calculated as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount (in $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue</td>
<td>788,000</td>
</tr>
<tr>
<td>Less: Cost of goods sold</td>
<td>(530,000)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>258,000</td>
</tr>
<tr>
<td>Less: Salary expense</td>
<td>90,000</td>
</tr>
<tr>
<td>Rent expense</td>
<td>24,000</td>
</tr>
<tr>
<td>Utilities</td>
<td>12,000</td>
</tr>
<tr>
<td>Telephone</td>
<td>3,000</td>
</tr>
<tr>
<td>Advertising</td>
<td>4,000</td>
</tr>
<tr>
<td>Bad debts</td>
<td>6,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>15,000</td>
</tr>
<tr>
<td>Health insurance for employees</td>
<td>6,000</td>
</tr>
<tr>
<td>Accounting and legal fees</td>
<td>4,000</td>
</tr>
<tr>
<td>Supplies</td>
<td>1,000</td>
</tr>
<tr>
<td>Net income</td>
<td>93,000</td>
</tr>
</tbody>
</table>

Only the $6,000 of health insurance paid for employees is deductible in calculating the net income of the sole proprietorship. Part of the $3,000 paid for Arnold qualifies for deduction for AGI treatment and the remainder is classified as a medical expense.

(2) The $8,000 interest on the City of Richmond bonds is excluded from gross income.

(3) Item a.

Amount realized | $22,000
Less: Adjusted basis | (30,000)
Realized loss | ($8,000)

Recognized loss (long-term capital loss) | ($8,000)

Item b.

The $60,000 inheritance is excluded from Arnold’s gross income. His adjusted basis for the Green stock is the cost of $60,000.

Item c.

Gifts are excluded from Arnold’s gross income. His adjusted basis for the Orange stock is a carryover basis of $6,000. His holding period also is a carryover holding period (i.e., it includes Aunt Jane’s holding period which began April 1, 1996).

Amount realized | $18,000
Less: Adjusted basis | (6,000)
Realized gain | $12,000

Recognized gain (long-term capital gain) | $12,000
**Item d.**

Amount realized $20,000
Less: Adjusted basis [1/2 X $60,000 (Item b.)] (30,000)
Realized loss ($10,000)

Recognized loss (short-term capital loss) ($10,000)

**Item e.**

Amount realized $-0-
Less: Adjusted basis (23,000)
Realized loss ($23,000)

Recognized loss (long-term capital loss) ($23,000)

The loss is deemed to occur on the last day of 2002. Therefore, the holding period is long-term.

**Item f.**

Amount realized ($160,000 + $40,000) $200,000
Less: Adjusted basis (181,000)
Realized gain $19,000

Recognized gain (long-term capital gain) $19,000

The exchange qualifies as a § 1031 like-kind exchange. However, since the boot received of $40,000 exceeds the realized gain of $19,000, all of the realized gain is recognized.

**Item g.**

Amount realized ($410,000 – $15,000) $395,000
Less: Adjusted basis (140,000)
Realized gain $255,000
§ 121 exclusion (250,000)
Recognized gain (long-term capital gain) $5,000

Arnold qualifies for the § 121 exclusion since he has owned and occupied the residence as his principal residence during at least two of the five years preceding the date of sale. Thus, his realized gain of $255,000 is reduced to $5,000.

Arnold’s basis for the residence he sold was the same as his and Carol’s basis ($140,000). Repair expenses ($5,000) are neither capitalizable nor deductible.

Arnold’s capital gains and losses are summarized as follows:

**Long-term capital gains:**

<table>
<thead>
<tr>
<th>Asset</th>
<th>Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orange stock</td>
<td>$12,000</td>
</tr>
<tr>
<td>Residence</td>
<td>5,000</td>
</tr>
<tr>
<td>Tucson land</td>
<td>19,000</td>
</tr>
</tbody>
</table>
Long-term capital losses:

Blue stock ($8,000)
Yellow stock (23,000)
Net long-term capital gain 

$5,000

Short-term capital loss:

Green stock ($10,000)

Net capital loss ($5,000 net long-term capital gain – $10,000 net short-term capital loss)

Only $3,000 of the net capital loss can be deducted in 2002. The $2,000 balance is carried forward to 2003.

(4) The alimony payment of $35,000 qualifies as a deduction for AGI. The child support of $8,000 is not deductible by Arnold.

(5) Computation of the self-employment tax:

Step 1 Net earnings from self-employment 

$93,000

Step 2 Multiply line 1 by 92.35%

$85,885.50

Step 3 If the amount on line 2 is more than $84,900, multiply the excess over $84,900 by 2.9% and add $12,989.70. This is the self-employment tax. Note: This amount is rounded to $13,018 on the tax return and entered in this solution at this amount.

The deduction for AGI for 50% of the self-employment tax is $6,509 ($13,018 X 50%).

(6) Of the $3,000 of health insurance premiums paid for Arnold, $2,100 ($3,000 X 70%) is a deduction for AGI and $900 ($3,000 – $2,100) is classified as a medical expense.

(7) Itemized deductions:

Medical expenses [($7,000 + $900) – (7.5% X $75,391)] $2,246
Property taxes 5,000
State income taxes 6,000
Charitable contributions 10,000
Mortgage interest 8,500
Lottery tickets 700
Total itemized deductions $32,446

(8) Arnold qualifies for a dependency deduction for Tom. Carol, the custodial parent, released the deduction to him.

(9) Arnold uses the Tax Table for a single individual to calculate his tax liability.

Taxable income $36,945
Tax liability $6,316
(10) Arnold qualifies for the child tax credit for his son, Tom. The credit would be $600. However, the phaseout provision reduces the amount of the credit to $550 ($600 – $50). Arnold’s AGI exceeds $75,000, and there is a $50 reduction for each $1,000 (or part thereof) of AGI above this threshold amount.
**Form 1040**

**U.S. Individual Income Tax Return 2002**

<table>
<thead>
<tr>
<th>Label</th>
<th>Social Security Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALFRED SINS</td>
<td>366-55-1111</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Use the IRS label. Otherwise, please print or type.</th>
</tr>
</thead>
<tbody>
<tr>
<td>CAROL SINS</td>
</tr>
</tbody>
</table>

**City, town, or post office.** If you have a foreign address, see instructions. **State ZIP code**

| Columbia | SC 29201 |

**Note:** Checking "Yes" will not change your tax or reduce your refund.

**Do you, or your spouse if filing a joint return, want $3 to go to this fund?**

<table>
<thead>
<tr>
<th>Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Single</td>
</tr>
<tr>
<td>2. Married filing jointly (even if only one had income)</td>
</tr>
<tr>
<td>3. Married filing separately. Enter spouse's SSN above &amp; full name here</td>
</tr>
</tbody>
</table>

**Important!**

You must enter your social security number(s) above.

**Filing Status**

<table>
<thead>
<tr>
<th>Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>6b. <strong>Yourself.</strong> If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a.</td>
</tr>
</tbody>
</table>

**Number of dependents: 2**

**Exemptions**

<table>
<thead>
<tr>
<th>Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Wages, salaries, tips, etc. <strong>Attach Form(s) W-2.</strong></td>
</tr>
<tr>
<td>2. <strong>Tax-exempt interest.</strong> Attach Schedule B (if required)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Social Security Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Ordinary dividends. <strong>Attach Schedule B (if required)</strong></td>
</tr>
<tr>
<td>10. <strong>Taxable refunds, credits, or offsets of state and local income taxes. (see instructions)</strong></td>
</tr>
<tr>
<td>11. <strong>Alimony received.</strong></td>
</tr>
<tr>
<td>12. <strong>Business income (or loss). Attach Schedule C or C-EZ.</strong></td>
</tr>
<tr>
<td>13. <strong>Capital gain or loss.</strong> Attach Schedule D. (If filed, do here.)</td>
</tr>
<tr>
<td>14. <strong>Other gains or losses.</strong> Attach Form 4797</td>
</tr>
<tr>
<td>15a. <strong>IRA distributions.</strong></td>
</tr>
<tr>
<td>15b. <strong>B Taxable amount (see instructions)</strong></td>
</tr>
<tr>
<td>16a. <strong>Pensions and annuities.</strong></td>
</tr>
<tr>
<td>16b. <strong>B Taxable amount (see instructions)</strong></td>
</tr>
<tr>
<td>17. <strong>Rental real estate, royalties, partnerships, S-corporations, trusts, etc. Attach Schedule E.</strong></td>
</tr>
<tr>
<td>18. <strong>Farm income (or loss). Attach Schedule F.</strong></td>
</tr>
<tr>
<td>19. <strong>Unemployment compensation.</strong></td>
</tr>
<tr>
<td>20a. <strong>Social security benefits.</strong></td>
</tr>
<tr>
<td>20b. <strong>B Taxable amount (see instructions)</strong></td>
</tr>
<tr>
<td>21. <strong>Other income.</strong> <strong>GANAN: GLANCE WINDINGS</strong></td>
</tr>
<tr>
<td>22. <strong>Add the amounts in the far right column for lines 7 through 21. This is your total income.</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Social Security Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>23. <strong>Educator expenses (see instructions)</strong></td>
</tr>
<tr>
<td>24. <strong>IRA deduction (see instructions)</strong></td>
</tr>
<tr>
<td>25. <strong>Student loan interest deduction (see instructions)</strong></td>
</tr>
<tr>
<td>26. <strong>Tuition and fees deduction (see instructions)</strong></td>
</tr>
<tr>
<td>27. <strong>Ancher MSA deduction. Attach Form 8883.</strong></td>
</tr>
<tr>
<td>28. <strong>Moving expenses. Attach Form 3903.</strong></td>
</tr>
<tr>
<td>29. <strong>One-half of self-employment tax.</strong> Attach Schedule SE.</td>
</tr>
<tr>
<td>30. <strong>Self-employed health insurance deduction (see instructions)</strong></td>
</tr>
<tr>
<td>31. <strong>Self-employed SEP, SIMPLE, and qualified plans</strong></td>
</tr>
<tr>
<td>32. <strong>Penalty on early withdrawal of savings</strong></td>
</tr>
<tr>
<td>33a. <strong>Alimony paid.</strong> <strong>B Recipients SSN.</strong></td>
</tr>
<tr>
<td>33b. <strong>Add lines 23 through 33a.</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Social Security Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>34. <strong>Add lines 33 through 33b.</strong> 11,250.</td>
</tr>
<tr>
<td>35. <strong>Subtract line 34 from line 22. This is your adjusted gross income.</strong> 21,428.</td>
</tr>
</tbody>
</table>

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

Property Transactions: Gain or Loss, Basis Considerations, Nontaxable Exchanges 12-51

88. continued

|------------------|---------------------|-------------|-------|

### Tax and Credits

- **36** Amount of line 35 (actual gross income)... 36 31,428.

### Standard Deduction for—
- **37a** Number of dependents claimed on return.
  - If you are married filing separately and your spouse is a dependent, see instructions.

### Itemized Deductions (Schedule A) or Standard Deduction (see left margin)

- **38** If line 36 is $100,000 or less, multiply $3,000 by the total number of exemptions claimed.
  - If line 36 is over $100,000, see the worksheet in the instructions.
- **39** If line 40 is more than line 39, enter 0.
- **40** Tax (see instructions). Check if any tax is from Form(s) 8814, 4922, 3900.
- **41** Alternative minimum tax (see instructions). Attach Form 6561.

### Other Taxes

- **44** Add lines 42 and 43.

### Payments

- **62** Federal income tax withheld from forms W-2 and 1099.
- **63** 2012 estimated tax payments and amount applied from 2011 return.
- **64** Earned income credit (EIC).

### Refund

- **70** If line 69 is more than line 61, subtract line 61 from line 69. This is the amount you have paid.

### Amount You Owe

- **73** Estimated tax (see instructions). See instructions.

### Third Party Designee

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

### Sign Here

- **75** Your signature...
- **76** Date...
- **77** Your occupation...
- **78** Daytime phone number...

### Paid Preparer’s Use Only

- **79** Preparer’s name...
- **80** Address...
- **81** Preparer’s SSN or PTIN...
- **82** Phone number...
88. continued

**SCHEDULE D**

*Attach to Form 1040.*  *See instructions for Schedule D (Form 1040).*

<table>
<thead>
<tr>
<th>Description of property (e.g., stock, bonds, or real estate)</th>
<th>Date acquired (Mo, day, yr)</th>
<th>Date sold (Mo, day, yr)</th>
<th>Sales price (see instructions)</th>
<th>Cost or other basis (see instructions)</th>
<th>Gain or (loss) (subtract (d) from (e))</th>
<th>20% rate gain or (loss)* (see instructions below)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Total short-term gain or (loss). Add lines 1 and 2 in column (f)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4797, 4884, 6781, and 6824.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule K-1.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Part II**

*20% rate gain or loss includes all "collectibles gains and losses" (as defined in the instructions) and up to 50% of the eligible gain on qualified small business stock (see instructions).*

**Long-Term Capital Gains and Losses — Assets Held More Than One Year**

<table>
<thead>
<tr>
<th>Description of property (e.g., stock, bonds, or real estate)</th>
<th>Date acquired (Mo, day, yr)</th>
<th>Date sold (Mo, day, yr)</th>
<th>Sales price (see instructions)</th>
<th>Cost or other basis (see instructions)</th>
<th>Gain or (loss) (subtract (d) from (e))</th>
<th>20% rate gain or (loss)* (see instructions below)</th>
</tr>
</thead>
<tbody>
<tr>
<td>8 6 sh stock</td>
<td>03/05/95</td>
<td>12/16/02</td>
<td>240.00</td>
<td>65.00</td>
<td>175.00</td>
<td></td>
</tr>
<tr>
<td>100 sh stock</td>
<td>07/14/92</td>
<td>10/08/02</td>
<td>1,500.00</td>
<td>2,200.00</td>
<td>-700.00</td>
<td></td>
</tr>
<tr>
<td>9 Enter your long-term totals, if any, from Schedule D-1, line B</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 Total long-term gain or (loss). Add lines 8 and 10 in column (f)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4797, 4884, 6781, and 6824.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule K-1.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Capital gain distribution. See instr.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 Combine lines 8 through 14 in column (g).</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f).</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Next: Go to Part III on page 2.
### Part III Taxable Gain or Deductible Loss

17 Combine lines 7 and 16 and enter the result. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 15, and complete Form 1040 through line 41.  
Next:  
**If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below.**  
**Otherwise, skip the rest of Schedule D and complete Form 1040.**

18 If line 17 is a loss, enter here and on Form 1040, line 18, the smaller of (a) the loss or (b) ($3,000) or, if married filing separately, ($1,500). Then complete Form 1040 through line 39.  
Next:  
**If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet in the instructions before completing the rest of Form 1040.**  
**Otherwise, skip Part IV below and complete the rest of Form 1040.**

### Part IV Tax Computation Using Maximum Capital Gains Rates

19 Enter your unrecovered Section 1250 gain, if any, from line 17 of the worksheet in the instructions.  

20 Enter your taxable income from Form 1040, line 41.  

21 Enter the smaller of line 16 or line 17 of Schedule B.  

22 If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4a. Otherwise, enter 0.  

23 Subtract line 22 from line 21. If zero or less, enter 0.  

24 Subtract line 23 from line 20. If zero or less, enter 0.  

25 Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedule, whichever applies.  

26 Enter the smaller of:  
- The amount on line 20 or  
- $45,700 if married filing jointly or qualifying widow(er);  
- $27,900 if single;  
- $37,400 if head of household; or  
- $23,850 if married filing separately.

If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.

27 Enter the amount from line 24.  

28 Subtract line 27 from line 26. If zero or less, enter 0 and go to line 34.  

29 Enter your qualified 5-year gain, if any, from line 6 of the worksheet in the instructions.  

30 Enter the smaller of line 28 or line 29.  

31 Multiply line 30 by 6% (0.06).  

32 Subtract line 31 from line 28.  

33 Multiply line 32 by 10% (0.10).  

If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.

34 Enter the smaller of line 20 or line 23.  

35 Enter the amount from line 26 (if line 26 is blank, enter 0).  

36 Subtract line 35 from line 34.  

37 Multiply line 36 by 20% (0.20).  

38 Add lines 36, 37, and 37.  

39 Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedule, whichever applies.  

40 Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42.
Form 1040
U.S. Individual Income Tax Return 2002

For the year Jan 1 - Dec 31, 2002, or other tax year beginning, X, ending, Y

IIT6 use only - Do not write on this line or in this space.

Label

Name

First name

Last name

Joint returnors separate.

Joint returnors separate.

Address

City, town or post office.

State or province.

ZIP code

Use the

IRS label.

Presidential

Election

Campaign

Note: Checking "Yes" will not change your tax or reduce your refund. You or your spouse if filing a joint return, want $3 to go to this fund? 

Filing Status

Check only one box.

1 Single

2 Married filing jointly (even if only one had income)

3 Married filing separately. Enter spouse's SSN above & full name here.

4 Head of household with qualifying person.

(exceptions: 

the qualifying person is a child but not your dependent, enter this child's name here.

Qualifying widow(er) with dependent child (year spouse died) 

Exemptions

No. of dependents claimed 

Income

Wages, salaries, tips, etc. Attach Form(s) W-2 .

a Taxable interest. Attach Schedule B if required.

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

Ordinary dividends. Attach Schedule B if required.

Taxable refunds, credits, or offsets of state and local income taxes (see instructions).

Alimony received.

Business income or loss. Attach Schedule C or C-EZ.

Capital gains or losses. Attach Schedule D (Form 1040), (Form 8949), or (Form 1116).

Other gains or losses. Attach Schedule D (Form 1040), (Form 8949), or (Form 1116).

Pensions and annuities

Social security benefits.

Farm income or loss. Attach Schedule F.

Unemployment compensation.

Social security benefits (see instructions).

Add the amounts in the last column for lines 23 through 25.

This is your adjusted gross income.

Add lines 23 through 30.

This is your adjusted gross income.

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

|------------------|--------------|-------------|--------|

**Property Transactions: Gain or Loss, Basis Considerations, Nontaxable Exchanges**

### Tax and Credits

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>36</td>
<td>Amount from line 35 (adjusted gross income)</td>
<td>75,391.</td>
<td>36</td>
<td>Amount from line 35 (adjusted gross income)</td>
<td>75,391.</td>
</tr>
<tr>
<td>37</td>
<td>a) Are you a single taxpayer?</td>
<td>Yes</td>
<td>37a</td>
<td>b) If yes, check if you were 65 or older; blind</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>b) If you are married and file jointly and your spouse itemizes deductions, or you were a dual-status alien, see instructions and check here</td>
<td></td>
<td>37b</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Standard Deduction**

- People who checked any box on line 37a or 37b or who can be claimed as a dependent, see instructions.
- All others: Single $4,700, Head of household $6,900, Married filing jointly or qualifying widow(er) $9,800

### Other Taxes

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>42</td>
<td>Alternative minimum tax (see instructions)</td>
<td>43</td>
<td>42</td>
<td>Alternative minimum tax (see instructions)</td>
<td>43</td>
</tr>
<tr>
<td>44</td>
<td>Add lines 42 and 43</td>
<td>44</td>
<td>44</td>
<td>Add lines 42 and 43</td>
<td>44</td>
</tr>
</tbody>
</table>

**Payments**

- If you have a qualifying child, attach schedule EIC
- Federal income tax withheld from Forms W-2 and 1099
- 2003 estimated tax payments and amount applied from 2001 return

### Refund

- Amount of refund you are entitled to | 1,216. |
- Amount of refund you are entitled to | 1,216. |

### Amount You Owe

- You may owe 20,000. |
- Estimated tax (see instructions) | 73   |

**Third Party Designee**

- You may want to allow another person to discuss this return with the IRS | Yes |
- Complete the following | No |

**Sign Here**

- Your signature | Date |
- Your occupation | Daytime phone number |

**Preparer’s Signature**

- Preparer’s name | Self-Prepared |
- Preparer’s address and phone number | |

---

FD 1012 129 2002
90. continued

### SCHEDULE A

**Form 1040**

**2002**

<table>
<thead>
<tr>
<th>Itemized Deductions</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Medical and Dental</strong></td>
<td></td>
</tr>
<tr>
<td>1. Medical and dental expenses (see instructions)</td>
<td>7,900.</td>
</tr>
<tr>
<td>2. Enter amount from Form 1040, line 36</td>
<td>75,391.</td>
</tr>
<tr>
<td>3. Multiply line 2 by 7.5% (0.075)</td>
<td>5,654.</td>
</tr>
<tr>
<td>4. Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-</td>
<td>2,246.</td>
</tr>
<tr>
<td><strong>Taxes You Paid</strong></td>
<td></td>
</tr>
<tr>
<td>5. State and local income taxes</td>
<td>6,800.</td>
</tr>
<tr>
<td>6. Real estate taxes (see instructions)</td>
<td>5,800.</td>
</tr>
<tr>
<td>7. Personal property taxes</td>
<td></td>
</tr>
<tr>
<td>8. Other taxes. List type and amount</td>
<td></td>
</tr>
<tr>
<td>9. Add lines 5 through 8</td>
<td>11,000.</td>
</tr>
<tr>
<td><strong>Interest You Paid</strong></td>
<td></td>
</tr>
<tr>
<td>10. Home mortgage interest reported to you on Form 1098</td>
<td>8,500.</td>
</tr>
<tr>
<td>11. Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying number, and address</td>
<td></td>
</tr>
<tr>
<td><strong>Gifts to Charity</strong></td>
<td></td>
</tr>
<tr>
<td>12. Gifts not reported to you on Form 1098. See instructions for sped sales</td>
<td>10,000.</td>
</tr>
<tr>
<td>13. Investment interest, Attach Form 4952 if required</td>
<td></td>
</tr>
<tr>
<td>14. Add lines 10 through 13</td>
<td>8,500.</td>
</tr>
<tr>
<td><strong>Casualty and Theft Losses</strong></td>
<td></td>
</tr>
<tr>
<td>15. Casualty or theft loss(es), Attach Form 4684, (See instructions)</td>
<td></td>
</tr>
<tr>
<td><strong>Job Expenses and Most Other Miscellaneous Deductions</strong></td>
<td></td>
</tr>
<tr>
<td>16. Unreimbursed employee expenses – job travel, union dues, job education, etc. You must attach Form 2106 or 2106-EZ</td>
<td></td>
</tr>
<tr>
<td>17. Add lines 10 through 13</td>
<td>10,000.</td>
</tr>
<tr>
<td><strong>Total Itemized Deductions</strong></td>
<td></td>
</tr>
<tr>
<td>18. Add lines 15 through 17</td>
<td></td>
</tr>
<tr>
<td>19. Enter amount from Form 1040, line 36</td>
<td></td>
</tr>
<tr>
<td>20. Multiply line 24 by 2% (0.02)</td>
<td>26. Subtract line 25 from line 24. If line 25 is more than line 24, enter -0-</td>
</tr>
<tr>
<td>21. Add lines 20 through 22</td>
<td></td>
</tr>
<tr>
<td>22. Other expenses – investment, safe deposit box, etc. List type and amount</td>
<td></td>
</tr>
<tr>
<td>23. Enter amount from Form 1040, line 36</td>
<td>100.</td>
</tr>
<tr>
<td>24. Multiply line 23 by 2% (0.02)</td>
<td></td>
</tr>
<tr>
<td>25. Subtract line 26 from line 22. If line 25 is more than line 26, enter -0-</td>
<td></td>
</tr>
<tr>
<td><strong>Total Itemized Deductions</strong></td>
<td></td>
</tr>
<tr>
<td>27. Add lines 20 through 22</td>
<td>28. Your deduction is limited. Add the amounts in the far right column for lines 4 through 27. Also, enter this amount on Form 1040, line 38.</td>
</tr>
</tbody>
</table>

**BAA For Paperwork Reduction Act Notice, see Form 1040 instructions.**

FD400301 10/28/02 Schedule A (Form 1040) 2002
### Schedule B — Interest and Ordinary Dividends

<table>
<thead>
<tr>
<th>Part I</th>
<th>Interest</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>First Bank</td>
<td>6,000.00</td>
</tr>
<tr>
<td></td>
<td>Second Bank</td>
<td>1,500.00</td>
</tr>
<tr>
<td></td>
<td>City of Richmond Bonds</td>
<td>8,000.00</td>
</tr>
</tbody>
</table>

**Note:** If you received a Form 1099-INT, From 1099-DIV, or a similar statement from a bank, broker, or other entity, list the name of the payer and enter the total dividend shown on that form.

**Subtotal:** 15,500.00

2. **Tax-Exempt Interest:** -8,000.00

3. **Add the amounts on line 1:** 7,500.00

4. **Exclude interest on series EE and I.U.S. savings bonds issued after 1986 from Form 1099, line 14. You must attach Form 8815:** 7,500.00

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

<table>
<thead>
<tr>
<th>Part II</th>
<th>Ordinary Dividends</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Swann, Inc.</td>
<td>3,000.00</td>
</tr>
<tr>
<td></td>
<td>Wren, Inc.</td>
<td>4,000.00</td>
</tr>
</tbody>
</table>

**Note:** If you received a Form 1099-DIV or similar statement form a bank, broker, or other entity, list the name of the payer and enter the total dividend shown on that form.

**Subtotal:** 13,000.00

6. **Add the amounts on line 5. Enter the total here and on Form 1040, line 8a.** 13,000.00

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

<table>
<thead>
<tr>
<th>Part III</th>
<th>Foreign Accounts and Trusts</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>7a</td>
<td>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.</td>
<td>[ ] Yes</td>
<td>[ ] No</td>
</tr>
<tr>
<td>7b</td>
<td>If Yes, enter the name of the foreign country:</td>
<td>[ ] Yes</td>
<td>[ ] No</td>
</tr>
<tr>
<td>8</td>
<td>During 2002, did you receive a distribution from, or were you the grantor of, or a transferee to, a foreign trust?</td>
<td>[ ] Yes</td>
<td>[ ] No</td>
</tr>
</tbody>
</table>

**BAA:** For Paperwork Reduction Act Notice, see Form 1040 Instructions.
90. continued

<table>
<thead>
<tr>
<th>SCHEDULE C</th>
<th>Profit or Loss from Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Form 1040)</td>
<td>(Sole Proprietorship)</td>
</tr>
</tbody>
</table>

**Name of partner:**

- **ARNOLD YOUNG**

**Social security number (SSN):**

- 999-55-2000

**Business address:**

- 1507 IRIS LANE
  - Tucson, AZ 85721

**Accounting method:**

- (3) Other (specify) $788,000

**Gross receipts or sales:**

- $788,000

**Part I Income**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross receipts or sales</td>
<td>$788,000</td>
</tr>
</tbody>
</table>

**Part II Expenses**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td>$4,000</td>
</tr>
<tr>
<td>Bad debts from sales or services</td>
<td>$6,000</td>
</tr>
<tr>
<td>Car and truck expenses</td>
<td>$1,000</td>
</tr>
<tr>
<td>Commissions and fees</td>
<td>$15,000</td>
</tr>
<tr>
<td>Depletion</td>
<td>$5,000</td>
</tr>
<tr>
<td>Depreciation and section 179 expense deduction (not included in Part III)</td>
<td>$12,000</td>
</tr>
<tr>
<td>Employee benefit programs (other than on line 19)</td>
<td>$6,000</td>
</tr>
<tr>
<td>Insurance (other than health)</td>
<td>$5,000</td>
</tr>
<tr>
<td>Interest</td>
<td>$4,000</td>
</tr>
<tr>
<td>Legal and professional services</td>
<td>$3,000</td>
</tr>
<tr>
<td>Office expense</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

**Part I Total expenses**

- $165,000

**Part II Total expenses before expenses for business use of home**

- $165,000

**Expenses for business use of home**

- $93,000

31. **Net profit (loss):**

- The net profit or loss is $93,000.

32. **If you have a loss,**

- Check the box that describes your investment in this activity (see instructions).

- **(a) All investment is at risk.**
  - If you checked 32a, enter the loss on Form 1040, line 12, and also on Schedule SE, line 2 (statutory employee, see instructions). Estates and trusts, enter on Form 1041, line 3.

- **(b) Some investment is at risk.**
  - If you checked 32b, you must attach Form 6198.
Property Transactions: Gain or Loss, Basis Considerations, Nontaxable Exchanges  12-59

90. continued

<table>
<thead>
<tr>
<th>Part III</th>
<th>Cost of Goods Sold (see instructions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>33</td>
<td>Method(s) used to value closing inventory</td>
</tr>
<tr>
<td>34</td>
<td>Was there any change in determining quantities, costs, or valuations between opening and closing inventory? If “Yes,” attach explanation</td>
</tr>
<tr>
<td>35</td>
<td>Inventory at beginning of year. If different from last year’s closing inventory, attach explanation</td>
</tr>
<tr>
<td>36</td>
<td>Purchases less cost of items withdrawn for personal use</td>
</tr>
<tr>
<td>37</td>
<td>Cost of labor. Do not include any amounts paid to yourself</td>
</tr>
<tr>
<td>38</td>
<td>Materials and supplies</td>
</tr>
<tr>
<td>39</td>
<td>Other costs</td>
</tr>
<tr>
<td>40</td>
<td>Add lines 35 through 38</td>
</tr>
<tr>
<td>41</td>
<td>Inventory at end of year</td>
</tr>
<tr>
<td>42</td>
<td>Cost of goods sold. Subtract line 41 from line 40. Enter the result here and on page 1, line 4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part IV</th>
<th>Information on Your Vehicle</th>
</tr>
</thead>
<tbody>
<tr>
<td>43</td>
<td>When did you place your vehicle in service for business purposes? (month; day; year)</td>
</tr>
<tr>
<td>44</td>
<td>Of the total number of miles you drove your vehicle during 2002, enter the number of miles you used your vehicle for:</td>
</tr>
<tr>
<td>45</td>
<td>Do you (or your spouse) have another vehicle available for personal use?</td>
</tr>
<tr>
<td>46</td>
<td>Was your vehicle available for personal use during off-duty hours?</td>
</tr>
<tr>
<td>47</td>
<td>Do you have evidence to support your deduction?</td>
</tr>
<tr>
<td>48</td>
<td>Total other expenses. Enter here and on page 1, line 27</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TELEPHONE</th>
<th>3,000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Schedule C (Form 1040) 2002

999-55-2000  Page 2
90. continued

<table>
<thead>
<tr>
<th>SCHEDULE D</th>
<th>Capital Gains and Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Form 1040)</td>
<td></td>
</tr>
<tr>
<td>Department of the Treasury</td>
<td>2002</td>
</tr>
<tr>
<td>Internal Revenue Service</td>
<td>attachment D-1 to list additional transactions for lines 1 and 2.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Part I: Short-Term Capital Gains and Losses - Assets Held One Year or Less**

<table>
<thead>
<tr>
<th>Description of property (example: 100 shares XYZ Co.)</th>
<th>Date acquired (Mo., day, yr.)</th>
<th>Date sold (Mo., day, yr.)</th>
<th>Sales price (see page D-5 of the instructions)</th>
<th>Cost or other basis (see page D-5 of the instructions)</th>
<th>Gain or (loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GREEN STK</td>
<td>05/15/02</td>
<td>07/15/02</td>
<td>20,000</td>
<td>30,000</td>
<td>-10,000</td>
</tr>
</tbody>
</table>

2. Enter your short-term totals, if any, from Schedule D-1, line 2.

3. **Total short-term sales price amounts.** Add lines 1 and 2 in column (d).

4. Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4797, 4798, 6781, and 8824.

5. Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1.

6. Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 2001 Capital Loss Carryover Worksheet.

7. **Net short-term capital gain or (loss).** Combine lines 1 through 6 in column (f).

**Part II: Long-Term Capital Gains and Losses - Assets Held More Than One Year**

<table>
<thead>
<tr>
<th>Description of property (example: 100 shares XYZ Co.)</th>
<th>Date acquired (Mo., day, yr.)</th>
<th>Date sold (Mo., day, yr.)</th>
<th>Sales price (see page D-5 of the instructions)</th>
<th>Cost or other basis (see page D-5 of the instructions)</th>
<th>Gain or (loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BLUE STK</td>
<td>09/05/99</td>
<td>03/12/02</td>
<td>22,000</td>
<td>30,000</td>
<td>-8,000</td>
</tr>
<tr>
<td>ORANGE STK</td>
<td>04/01/98</td>
<td>07/01/02</td>
<td>18,000</td>
<td>6,000</td>
<td>12,000</td>
</tr>
<tr>
<td>YELLOW STK Worthless</td>
<td>09/01/01</td>
<td>12/31/02</td>
<td>0</td>
<td>23,000</td>
<td>-23,000</td>
</tr>
</tbody>
</table>

9. Enter your long-term totals, if any, from Schedule D-1, line 9.

10. **Total long-term sales price amounts.** Add lines 8 and 9 in column (d).

11. Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4797, 4798, 6781, and 8824.

12. Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1.

13. Capital gain distributions. See page D-1 of the instructions.

14. Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 2001 Capital Loss Carryover Worksheet.

15. **Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (f).

16. **Next:** Go to Part III on the back.

*28% rate gain or loss includes all "collectibles gains and losses" (as defined on page D-6 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page D-4 of the instructions).

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11338H Schedule D (Form 1040) 2002
90. continued

### Part III Taxable Gain or Deductible Loss

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>17</td>
<td>Combine lines 7 and 18 and enter the result. If it is a loss, go to line 18. If it is a gain, enter the gain on Form 1040, line 15, and complete Form 1040 through line 41. Next: If both lines 16 and 17 are gains and Form 1040, line 41, is more than zero, complete Part IV below. Otherwise, skip the rest of Schedule D and complete Form 1040.</td>
</tr>
<tr>
<td>18</td>
<td>If line 17 is a loss, enter here and on Form 1040, line 18, the smaller of (a) the loss or (b) ($3,000) or, if married filing separately, ($1,500). Then complete Form 1040 through line 39. Next: If the loss on line 17 is more than the loss on line 18 or if Form 1040, line 39, is less than zero, skip Part IV below and complete the Capital Loss Carryover Worksheet in the instructions before completing the rest of Form 1040. Otherwise, skip Part IV below and complete the rest of Form 1040.</td>
</tr>
</tbody>
</table>

### Part IV Tax Computation Using Maximum Capital Gains Rates

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>19</td>
<td>Enter your unrecovered Section 1250 gain, if any, from line 17 of the worksheet in the instructions.</td>
</tr>
<tr>
<td>20</td>
<td>Enter your taxable income from Form 1040, line 14.</td>
</tr>
<tr>
<td>21</td>
<td>Enter the smaller of line 16 or line 17 of Schedule D.</td>
</tr>
<tr>
<td>22</td>
<td>If you are deducting investment interest expense on Form 4952, enter the amount from Form 4952, line 4d. Otherwise, enter 0.</td>
</tr>
<tr>
<td>23</td>
<td>Subtract line 22 from line 21. If zero or less, enter 0.</td>
</tr>
<tr>
<td>24</td>
<td>Subtract line 23 from line 20. If zero or less, enter 0.</td>
</tr>
<tr>
<td>25</td>
<td>Figure the tax on the amount on line 24. Use the Tax Table or Tax Rate Schedules, whichever applies.</td>
</tr>
<tr>
<td>26</td>
<td>Enter the smaller of:</td>
</tr>
<tr>
<td></td>
<td>• The amount on line 20 or</td>
</tr>
<tr>
<td></td>
<td>• $46,700 if married filing jointly or qualifying widow(er); $27,900 if single; $37,400 if head of household; or $23,300 if married filing separately</td>
</tr>
<tr>
<td></td>
<td>If line 26 is greater than line 24, go to line 27. Otherwise, skip lines 27 through 33 and go to line 34.</td>
</tr>
<tr>
<td>27</td>
<td>Enter the amount from line 24.</td>
</tr>
<tr>
<td>28</td>
<td>Subtract line 27 from line 26. If zero or less, enter 0 and go to line 24.</td>
</tr>
<tr>
<td>29</td>
<td>Enter your qualified 6-year gain, if any, from line 6b of the worksheet in the instructions.</td>
</tr>
<tr>
<td>30</td>
<td>Enter the smaller of line 28 or line 29.</td>
</tr>
<tr>
<td>31</td>
<td>Multiply line 30 by 6% (0.06).</td>
</tr>
<tr>
<td>32</td>
<td>Subtract line 30 from line 28.</td>
</tr>
<tr>
<td>33</td>
<td>Multiply line 32 by 10% (0.10).</td>
</tr>
<tr>
<td>34</td>
<td>If the amounts on lines 23 and 28 are the same, skip lines 34 through 37 and go to line 38.</td>
</tr>
<tr>
<td>35</td>
<td>Enter the smaller of line 20 or line 23.</td>
</tr>
<tr>
<td>36</td>
<td>Enter the amount from line 26 if line 26 is blank, enter 0.</td>
</tr>
<tr>
<td>37</td>
<td>Multiply line 36 by 20% (0.20).</td>
</tr>
<tr>
<td>38</td>
<td>Add lines 35, 36, 37, and 38.</td>
</tr>
<tr>
<td>39</td>
<td>Figure the tax on the amount on line 20. Use the Tax Table or Tax Rate Schedules, whichever applies.</td>
</tr>
<tr>
<td>40</td>
<td>Tax on all taxable income (including capital gains). Enter the smaller of line 38 or line 39 here and on Form 1040, line 42.</td>
</tr>
</tbody>
</table>

BAA Schedule D (Form 1040) 2002
### Part I  Short-Term Capital Gains and Losses—Assets Held One Year or Less

<table>
<thead>
<tr>
<th></th>
<th>Description of property (Example: 100 st. XYZ Cts.)</th>
<th>Date acquired (Mo., day, yr.)</th>
<th>Date sold (Mo., day, yr.)</th>
<th>Sales price (see page D-5 of the instructions)</th>
<th>Cost or other basis (see page D-5 of the instructions)</th>
<th>Gain or (loss)</th>
<th>Section 12 exclusion</th>
<th>Gain or (loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Home sale gain realized</td>
<td>12/01/92</td>
<td>12/01/92</td>
<td>410,000</td>
<td>00</td>
<td>255,000</td>
<td>-260,000</td>
<td>00</td>
</tr>
</tbody>
</table>

**2 Totals.** Combine columns (e) and (f). Enter here and on Schedule D, line 2.

- 410,000
- 00
- 5,000
- 00
90. continued

Section A — Short Schedule SE. Caution. Read above to see if you can use Short Schedule SE

1 Net farm profit (loss) from Schedule F, line 16, and farm partnerships, Schedule K-1 (Form 1065), line 16a .............................. 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 (ministers and members of religious orders, see instructions for amounts to report on this line. See instructions for other income to report) ........................................ 2 $93,000.

3 Combine lines 1 and 2. ........................................ 3 $93,000.

4 Net earnings from self-employment. Multiply line 3 by 92.36% (0.9236). If less than $400, do not file this schedule; you do not owe self-employment tax. ........................................ 4 $85,886.

5 Self-employment tax. If the amount on line 4 is:
   • $84,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on Form 1040, line 56. ........................................ 5 $13,018.
   • More than $84,000, multiply line 4 by 2.9% (.029). Then, add $10,527.60 to the result. Enter the total here and on Form 1040, line 56. ........................................ 6 6,509.

BAA, For Paperwork Reduction Act Notice, see Form 1040 instructions. Schedule SE (Form 1040) 2002

FDIA1101  6122002
90. continued

---

**Form 4562**

**Depreciation and Amortization**

(Including Information on Listed Property)

- See separate instructions.
- Attach to your tax return.

**2002**

**67**

**Sch C SALES**

**Part I**  
**Election To Expense Certain Tangible Property Under Section 179**

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

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Maximum amount. See instructions for a higher limit for certain businesses.</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Total cost of section 179 property placed in service (see instructions).</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>Threshold cost of section 179 property before reduction in limitation.</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter 0.</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter 0. If marked filing separately, see instructions.</td>
<td>5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>(a) Description of property</th>
<th>(b) Cost (business use only)</th>
<th>(c) Elect. cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>15,000.</td>
<td>15,000.</td>
<td></td>
</tr>
</tbody>
</table>

7 Listed property. Enter the amount from line 29.  
8 Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7.  
9 Tentative deduction. Enter the smaller of line 5 or line 8.  
10 Carrying of disallowed deduction. Subtract line 8 from line 13 of your 2001 Form 4562.  
11 Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions.  
12 Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11.  
13 Carrying of disallowed deduction to 2003. Add lines 9 and 10, less line 12.  

Note: Do not use Part II or Part III below for 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 MACRS) (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(g)(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) Month and year placed in service</th>
<th>(c) Basis for depreciation</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>25 yrs</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19b 5-year property</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19c 7-year property</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19d 10-year property</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19e 15-year property</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19f 20-year property</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19g 25-year property</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19h Residential rental property</td>
<td>27.5 yrs</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19i Nonresidential real property</td>
<td>39 yrs</td>
<td>S/L</td>
<td></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) Classification of property</th>
<th>(b) Month and year placed in service</th>
<th>(c) Basis for depreciation</th>
<th>(d) Recovery period</th>
<th>(e) Convention</th>
<th>(f) Method</th>
<th>(g) Depreciation deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>20a Class B</td>
<td>12 yrs</td>
<td>S/L</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20b 12-year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20c 40-year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

**Part IV**  
**Summary (see instructions)**

21 Listed property. Enter amount from line 28.  
22 Total. Add amounts from line 12, lines 14 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.  

---

**BAA For Paperwork Reduction Act Notice, see instructions.**
90. continued

**Part I**  Information on the Like-Kind Exchange

Note: If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.

1. Description of like-kind property given up ▶ LAND - TUCSON

2. Description of like-kind property received ▶ LAND - PHOENIX

3. Date like-kind property given up was originally acquired (month, day, year) ........................................... 3  09/18/1999

4. Date you actually transferred your property to other party (month, day, year) ........................................... 4  08/15/2002

5. Date like-kind property you received was identified (month, day, year) (see instructions) ........................................... 5  08/15/2002

6. Date you actually received the like-kind property from other party (month, day, year) ........................................... 6  08/15/2002

7. Was the exchange made with a related party (see instructions)? If "Yes," complete Part II. If "No," go to Part III.
   a □ Yes, in this tax year  
   b □ Yes, in a prior tax year  
   c X No

**Part II**  Related Party Exchange Information

<table>
<thead>
<tr>
<th>Name of related party</th>
<th>Related party's identifying number</th>
</tr>
</thead>
</table>

City of town  
State  
ZIP code  
Relationship to you

9. During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of the like-kind property received from you in the exchange? □ Yes □ No

10. During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of the like-kind property you received? □ Yes □ No

If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "Yes" and this is not the year of the exchange, stop here. Either line 9 or line 10 is "Yes", complete Part III and report on this year's tax return the deferred gain or loss from line 24 unless one of the exceptions on line 11 applies. See Related party exchanges in the instructions.

11. If one of the exceptions below applies to the disposition, check the applicable box:
   a □ The disposition was after the death of either of the related parties.
   b □ The disposition was involuntary conversion, and the threat of conversion occurred after the exchange.
   c □ You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as its principal purpose. If this box is checked, attach an explanation (see instructions).

**Part III**  Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: If you transferred and received (a) more than one group of like-kind properties or (b) cash or other (not like-kind) property, see Reporting of multi-asset exchanges in the instructions.

Note: Complete lines 12 through 14 only if you gave up property that was not like-kind. Otherwise, go to line 15.

12. Fair market value (FMV) of other property given up ........................................... 12  

13. Adjusted basis of other property given up ........................................... 13  

14. Gain or (loss) recognized on other property given up: Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale ........................................... 14  

15. Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred (see instructions) ........................................... 15  40,000

16. FMV of like-kind property you received ........................................... 16  160,000

17. Add lines 15 and 18 ........................................... 17  200,000

18. Adjusted basis of like-kind property you gave up, net amounts paid to other party, and any exchange expenses not used on line 15 (see instructions) ........................................... 18  181,000

19. Realized gain or (loss), Subtract line 18 from line 17. ........................................... 19  19,000

20. Enter the smaller of line 15 or line 19, but not less than zero ........................................... 20  19,000

21. Ordinary income under recapture rules. Enter here and on Form 4797, line 16 (see instructions) ........................................... 21

22. Subtract line 21 from line 20. If zero or less, enter -0. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies (see instructions) ........................................... 22  19,000

23. Recognized gain. Add lines 21 and 22 ........................................... 23  19,000

24. Deferred gain or (loss). Subtract line 23 from line 19. If related party exchange, see instructions. ........................................... 24  0

25. Basis of like-kind property received. Subtract line 15 from the sum of lines 19 and 23 ........................................... 25  160,000
Form 8332  

Release of Claim to Exemption for Child of Divorced or Separated Parents

Caution: Do not use this form if you were never married.

Name of noncustodial parent claiming exemption: ARNOLD YOUNG  
Social security number (SSN): 999-55-2000

Part I  Release of Claim to Exemption for Current Year

I agree not to claim an exemption for TOM YOUNG, Name(s) of child (or children), for the tax year 20__.

Signature of custodial parent releasing claim to exemption:  
Custodial parent’s SSN: 999-33-3000  
Date: __________

Note: If you choose not to claim an exemption for this child (or children) for future tax years, also complete Part II.

Part II  Release of Claim to Exemption for Future Years (If completed, see Noncustodial parent below.)

I agree not to claim an exemption for__________________________, Name(s) of child (or children), for the tax year(s): ____________________________

Signature of custodial parent releasing claim to exemption:  
Custodial parent’s SSN: ____________________________  
Date: ____________________________

General Instructions

Purpose of form. If you are a custodial parent and you were ever married to the child’s noncustodial parent, you may use this form to release your claim to your child’s exemption. To do so, complete this form (or a similar statement containing the same information required by this form) and give it to the noncustodial parent who will claim the child’s exemption. The noncustodial parent must attach this form or similar statement to his or her tax return each year the exemption is claimed.

You are the custodial parent if you had custody of the child for most of the year. You are the noncustodial parent if you had custody for a shorter period of time or did not have custody at all. For the definition of custody, see Pub. 501, Exemptions, Standard Deduction, and Filing Information.

Support test for children of divorced or separated parents. Generally, the custodial parent is treated as having provided over half of the child’s support if:

- The child received over half of his or her total support for the year from one or both of the parents and
- The child was in the custody of one or both of the parents for more than half of the year.

Note: Public assistance payments, such as Temporary Assistance for Needy Families (TANF), are not support provided by the parents.

For this support test to apply, the parents must be one of the following:

- Divorced or legally separated under a decree of divorce or separate maintenance.
- Separated under a written separation agreement, or
- Living apart at all times during the last 6 months of the year.

Caution: This support test does not apply to parents who never married each other.

Specific Instructions

Custodial parent. You may agree to release your claim to the child’s exemption for the current tax year or for future years, or both.

- Complete Part I if you agree to release your claim to the child’s exemption for the current tax year.
- Complete Part II if you agree to release your claim to the child’s exemption for any or all future years. If you do, write the specific future year(s) or "all future years" in the space provided in Part II.

To help ensure future support, you may not want to release your claim to the child’s exemption for future years.

Noncustodial parent. Attach this form or similar statement to your tax return each year you claim the child’s exemption. You may claim the exemption only if the other four dependency tests in your tax return instruction booklet are met.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

- Recordkeeping: 7 min.
- Learning about the law or the form: 5 min.
- Preparing the form: 7 min.
- Copying, assembling, and sending the form to the IRS: 14 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95740-3001. Do not send the form to this address. Instead, see the instructions for Form 1040 or Form 1040A.