APPENDIX F

Comprehensive Tax Return Problems

PROBLEM 1

Daniel J. and Irene T. Bean, ages 40 and 38, are husband and wife, and reside at 1340 Grand Avenue, Hunt, WV 26506. Both are employed—Dan is a process engineer with Cardinal Chemical Corporation, and Irene is a dietician for Mercy Hospital. Information that relates to their Federal income tax liability for 2002 is noted below.

1. Dan's regular annual salary is $58,000. His employer, Cardinal Chemical Corporation, declares a bonus for its employees in December of each year payable in January of the following year. Dan received a $5,000 bonus in January 2002 (for 2001) and $4,000 in January of 2003 (for 2002).
2. For 2002, Irene received a salary of $34,000 from Mercy Hospital. By conducting weight-control programs as a freelance consultant, Irene is able to earn an additional $10,500. Mercy hospital is not involved in these programs but does allow Irene free use of its meeting facilities.
3. For several years, Irene's widowed mother, Mona Tipton (age 60), has lived with the Beans. On January 20, 2002, Mona met an untimely end when she was struck by a city bus while crossing a street in downtown Charleston. As the bus driver was clearly at fault, the city offered to settle the matter to avoid a lawsuit. On December 3, 2002, and as the executor of Mona's estate, Irene accepted a cash award of $100,000 in satisfaction of her mother's personal injury litigation rights. The city of Charleston also paid for Mona's funeral expenses of $6,300. Under Mona's will, Irene is named as the sole heir.
4. Unknown to Irene, Mona carried an insurance policy on her own life. The policy was issued by Eagle Mutual of Canada, had a maturity value of $150,000, and designated Irene as the beneficiary. Apparently, the publicity surrounding Mona's accident placed the insurance company on notice of her death. As a result, Irene received a check from Eagle on December 27, 2002, for $151,500 ($150,000 insurance proceeds plus $1,500 post-death accrued interest).
5. Dan's divorced father, Walter (age 66), also is a member of the Bean's household. Walter is physically handicapped and is forced to use a wheel chair. In order to ease his father's mobility problem, during the summer of 2002 Dan had a contractor make certain capital changes to the residence. Wheel chair ramps were installed at the entrances, certain counters were lowered and guard rails added to bathroom facilities. The improvements cost the Beans $12,000. A nearby neighbor who is a real estate broker estimates that the improvements increased the resale value of the residence by $10,000. This increase in value is attributable to the large number of retirees who are living in the area or are moving there.
6. Four times a year, Dan attends an all day seminar sponsored by the West Virginia Society of Chemical Engineers. As to each session, he drives to the meeting site, attends the technical seminar, and returns home the same day. Costs incurred for the 2002 meetings are: $600 (registration fees), $120 (lunches) and $60 (parking and tolls). Mileage driven is 440 miles.
7. In 2002, Dan enrolls in a weekend MBA program at a nearby university. Costs incurred are: $3,200 tuition, $600 books, $300 computer supplies, and $210 meals. Dan does not stay overnight on campus but commutes from home. Mileage driven is 1,200 miles.

8. In mid-2002, Irene became dissatisfied with her job when she failed to receive a merit increase from Mercy Hospital. As a result she consulted a placement service, prepared résumés, and scheduled numerous interviews. After incurring expenses of $3,100, Irene came to the conclusion that job opportunities in her profession were not attractive enough to warrant a change of employers.

9. On their Federal income tax return for tax year 2001, the Beans had an *excess* short-term capital loss of $4,000 that they could not deduct and which carries over to 2002. Other Schedule D transactions for 2002 are summarized below.

Description of Asset	Date Acquired	Date Sold	Cost or Other Basis	Sales Price
1958 DeSoto convertible	01/20/02	12/30/02	See below	$20,500
500 shares of Dove Corporation common stock	11/22/00	07/10/02	See below	13,000
400 shares of Lark Corporation common stock	02/19/99	05/07/02	$15,000	17,000
800 shares of Owl Corporation common stock	07/10/01	12/23/02	10,000	8,000

The DeSoto automobile was inherited by Irene from Mona. The car had been purchased new by Mona and carefully maintained by her. A local car dealership estimated that it originally cost Mona $3,200 and that it was worth $20,000 when she died.

The Dove Corporation stock was received by Dan as a gift from Walter on November 22, 2000, at a time when it was worth $20,000. It had been purchased by Walter on April 2, 1997, for $8,000. No gift tax was incurred on the transfer.

The Beans consider the stock in Owl Corporation to be a good investment with attractive growth potential. They sold the stock to harvest a loss to offset some of the gain on the Lark Corporation stock. On January 8, 2003, they purchased 800 shares of Owl Corporation common stock for $7,800.

10. Besides the items previously mentioned, the Beans had the following receipts during 2002:

• Interest on certificate of deposit issued by Morgantown State Bank		$800
• Interest on money market account with Hunt State Bank		300
• Interest on bonds issued by the State of West Virginia		450
• Income tax refunds for tax year 2001 received from—		
State of West Virginia	$120	
IRS	410	530

In addition, the Beans won a wide screen color TV set at a raffle sponsored by their church. The set had a retail value of $1,200 (wholesale price paid by the church was $700).

11. Besides Mona and Walter, the Bean's household in 2002 included their daughter, Susan (age 17) and their son, James (age 14). Dan and his sister, Mary Stewart, each provides 40% of the support of their mother, Laura (age 65). The other 20% is furnished by Laura from Social Security benefits. Laura lives with Mary at 4612 Main, Bowling Green, KY 42101. Mary has agreed to assign the dependency exemption to the Beans and has sent Dan a signed Form 2120. The Beans furnished more than one half of the support of Mona and Walter and all of the support of their children.

12. The Bean's expenditures during 2002 are as follows:

Medical—			
Employee contributions to medical insurance plans ($2,400 for Dan and $1,900 for Irene) sponsored by employers (Cardinal Chemical Corporation and Mercy Hospital)		$4,300	
Dr. Taylor (orthodontist)		1,600	$5,900
Taxes—			
State income tax:			
Amounts withheld (see item 13 below)	$4,209		
Additional payment made (4/15/02)	300	$4,509	
Property taxes on personal residence		3,200	7,709
Interest on home mortgage			4,800
Payment of church pledge (St. John the Divine)			2,400
Employment related expenses (not reimbursable)—			
Lab coats (Dan)		$ 320	
Laundry of lab coats (Dan)		250	
Safety clothing—shoes, glasses, gloves (Dan)		180	
Professional dues ($100 Dan, $120 Irene)		220	
Professional journals ($120 Dan, $90 Irene)		210	1,180
Instructional materials used by Irene to teach her weight-control programs			260

The medical insurance the Beans have through their employers does not cover dental procedures. Nor does the insurance cover Walter. Moreover, Walter insisted on paying his own medical expenses.

13. The income taxes withheld by Dan's and Irene's employers (i.e., Cardinal Chemical Corporation and Mercy Hospital) for 2002 are summarized below:

	Dan	**Irene**
Federal income tax	$7,192	$2,592
State income tax	2,903	1,306

For tax year 2002, the Beans made total quarterly payments to the IRS of $4,000 ($1,000 each quarter). As to additional payments made toward West Virginia's income tax, see item 12 above.

14. Security numbers for the parties involved are as follows:

Name	**Social Security Number**
Daniel J. Bean	233–49–1648
Irene T. Bean	233–32–2831
Mona R. Tipton	232–18–3914
Walter E. Bean	232–14–6822
Susan M. Bean	235–65–5194
James W. Bean	235–91–4615
Laura P. Bean	232–63–5243
Mary S. Stewart	233–24–6124

Requirements

Prepare a joint return (with appropriate schedules) for the Beans for year 2002. In this regard, make the following assumptions.

- They itemized their deductions for the previous year (i.e., 2001).
- As to deductible mileage, they use the automatic mileage method.
- The principal business code for Irene's Schedule C is 812190.
- If any refund is due, they want it sent to them.
- They are preparing their own return (i.e., no preparer is involved).
- They do not want to contribute to the Presidential Election Campaign fund.

PROBLEM 2

Alfred S. and Melinda N. Hill (ages 67 and 65) are husband and wife and live in a rented condo located at 1412 Arbor Drive, Clark, WA 98195. Al is the owner and manager of several retail liquor outlets, while Melinda is a homemaker and an amateur artist of some local repute.

1. When Parkway Mall first started in 1993, Al leased space and established "Al's Grog Shop," offering a full line of alcoholic beverages (including beer and wine) and tobacco products. As the mall catered to middle to upper income clientele, Al's store was an immediate success. Al had considerable past experience in retailing and was very effective in promoting his store.
2. When a downtown liquor store went out of business, Al purchased the land and building. Located at 1200 S. Main, the building is a recently constructed, two-floor brick structure containing 7,500 square feet of usable space. The title transfer occurred on March 1, 1999, and Al opened for business immediately. Of the purchase price of $400,000, one-eighth ($50,000) was allocated to the land and the balance to the building. Various existing improvements (e.g., counters, shelves, wine racks) were not accounted for separately, as many were in the nature of fixtures, and all were treated as part of the building. Al proved to be correct when he predicted that the downtown location would succeed. Many of his new customers who worked downtown lived near the mall location. They were, therefore, familiar with the Al's Grog Shop operation and aware of its reputation for service and quality. The downtown location was particularly convenient for servicing office parties on special occasions, particularly during the Christmas season.
3. Al's Grog Shop is operated as a sole proprietorship. It uses a calendar year for tax purposes and, except in determining cost of good sold, reports its activities on a cash basis. The business code for beer, wine, and liquor stores is 445310, and the employer identification number is 53–4758905.
4. Cost of goods sold and gross profit information for calendar year 2002 is as follows:

Sales		$ 3,102,520
Cost of goods sold—		
Beginning inventory	$ 430,000	
Purchases	2,110,000	
Less final inventory	(405,000)	(2,135,000)
Gross profit		$ 967,520

Year-end inventories are determined on a physical count basis. Inventory is valued at the lower of cost or market. Losses due to spoilage and breakage are minimal and are not accounted for separately. Theft of goods by employees and customers is unknown but may be substantial (see item 7 below). What is stolen, however, reduces the final inventory amount.