

**Gleim CPA Review**  
**Updates to Taxation and Regulation**  
2024 Edition, 1st Printing  
July 2024

NOTE: Sections with changes are indicated by a vertical bar in the left margin. Text that should be deleted is displayed with a line through it. New text is shown with blue underlined font.

The revisions included in this PDF primarily reflect tax laws that became effective January 1, 2024. These tax laws are testable on the CPA Exam beginning July 1, 2024. All Gleim outlines, questions, and simulations have been updated accordingly.

This update does not include outline sections or questions in which the only changes were to update tax years. Please note that these need to be updated by you for your book. Our online materials already reflect all tax year updates. As of the date of this update, the IRS has not yet released all of the 2024 tax forms. Please check [www.gleim.com/taxforms](http://www.gleim.com/taxforms) for any updates. The IRS forms will be updated online as they are released.

## **Study Unit 1 – Ethics, Professional Responsibilities, and Liability of CPAs**

Page 17, Subunit 1.1:

- Enrolled agents (EAs)
  - An EA is an individual, other than an attorney or a CPA, who is eligible, qualified, and ~~certified~~licensed as authorized to represent a taxpayer before the IRS.

Pages 24 and 28, Subunit 1.2, under Penalties:

- The tax code provides that any tax return preparer who endorses or otherwise **negotiates** any check issued to a taxpayer with respect to taxes imposed by the IRC is subject to a penalty of ~~\$600~~635 per check.

[...]

Act	Fine	Imprisonment
<b>Understatement:</b>		
Due to unreasonable positions <a href="#">[IRC Sec. 6694(a)]</a>	Greater of a) \$1,000 or b) 50% of income to be derived	N/A
Due to willful or reckless conduct <a href="#">[IRC Sec. 6694(b)]</a>	Greater of a) \$5,000 or b) 75% of income to be derived	N/A
<b>Preparing tax returns for other persons <a href="#">(IRC Sec. 6695)</a>:</b>		
Various failures related to furnishing a complete, signed copy of the return to the taxpayer	\$60 each	N/A
Failure to file correct information returns	\$60 each	N/A
Endorses or negotiates checks made to taxpayer in respect of taxes imposed	<del>\$600</del> <a href="#">635</a> each, unlimited	N/A
Failure to be diligent in determining credits and head of household status (for the best benefit of taxpayer)	<del>\$600</del> <a href="#">635</a> each, unlimited	N/A
<b>Others:</b>		
Promoting abusive tax shelters <a href="#">[IRC Sec. 6700(a)]</a>	<b>False statements about the tax benefits of the transaction:</b> 50% of the income to be derived <b>Provides a gross valuation overstatement:</b> Lesser of a) \$1,000 for each organization or sale of promotion plan b) <a href="#">100% of income</a> to be derived	N/A
Aiding and abetting understatement of tax liability <a href="#">[IRC Sec. 6701(a)]</a>	<b>Identity theft crime:</b> \$1,000 per unauthorized disclosure, limited to \$50,000 per year <del><b>Other:</b> \$250 per unauthorized disclosure, limited to \$10,000 per year</del>	N/A
Disclosure or use of information <a href="#">[IRC Sec. 6713(a)]</a>	\$250 per unauthorized disclosure, limited to \$10,000 per year	N/A
Convicted of knowingly or recklessly disclosing information (misdemeanor) <a href="#">(IRC Sec. 7216)</a>	\$1,000	Up to 1 year
<del>Fraud and false statements</del> <a href="#">False or fraudulent tax returns (IRC Sec. 7206)</a>	\$100,000 (individual clients) \$500,000 (corporate clients)	Up to 3 years
Fraudulent returns, statements, or other documents <a href="#">(IRC Sec. 7207)</a>	\$10,000 (individual clients) \$50,000 (corporate clients)	Up to 1 year

## Study Unit 2 – Federal Tax Authority, Procedures, Individual Taxation, and Tax-Exempt Organizations

Pages 53-54, Subunit 2.2, under Filing Requirements:

- Is a dependent (i.e., listed on another person's tax return) with more gross income than the standard deduction or with unearned income over \$1,250 1,300.

[...]

- Calculation of net unearned income is unearned income minus the sum of
  - \$1,250 1,300 (first \$1,250 1,300 clause) and
  - The greater of (1) \$1,250 1,300 of the standard deduction or \$1,250 1,300 of itemized deductions or (2) the amount of allowable deductions that are directly connected with the production of unearned income.
- A dependent is allowed at least \$2,500 2,600 (\$1,250 1,300 + \$1,250 1,300) reduction in unearned income.

### Example 2-1 Taxable Income of a Dependent Child

Chris, dependent child age 5, has \$4,900 5,000 of unearned income and no earned income. How much of his income will be subject to the Kiddie Tax?

Unearned income	\$4,900 <u>5,000</u>
First \$1,250 <u>1,300</u> clause	(1,250 <u>1,300</u> )
Standard deduction	(1,250 <u>1,300</u> )
Net unearned income	<u>\$2,400</u>

Page 56, Subunit 2.2, under Dependents, Qualifying Relative:

**Gross taxable income.** The person's gross income for the year must be less than \$4,700 5,050. Gross income means all income the person received in the form of money, goods, property, and services that is not exempt from tax (e.g., taxable interest income and taxable scholarships).

- This does **not** include Social Security benefits for low-income taxpayers.

Page 62, Subunit 2.3, under Penalties:

**Failure to file penalty.** A penalty of 5% per month up to 25% of unpaid liability is assessed for failure to file a return. Additionally, the minimum penalty for filing a return over 60 days late is the lesser of \$485 510 (for 2023 2024 returns filed in 2024 2025) or 100% of tax due.

## Page 67, Subunit 2.4, under Cash Method vs. Accrual Method, Accrual Method:

- The accrual method is required for the following individuals, entities, or situations:
  - Generally, C corporations, partnerships with a C corporation as a partner, charitable trusts with unrelated income, and tax shelters.
    - ▶ However, entities that meet the gross receipts test by having ~~\$29~~30 million or less average gross receipts in the 3 preceding years and are not tax shelters can use the cash method.
  - A taxpayer who maintains inventory must use the accrual method with regard to purchases and sales.

## Page 74, Subunit 2.2, Question 5:

5. Chris, age 5, has ~~\$3,900~~4,000 of interest income and **no** earned income in ~~2023~~2024. Assuming the current applicable standard deduction is ~~\$1,250~~1,300, how much of Chris's income will be subject to the Kiddie Tax?

- A. \$0
- B. \$1,400
- C. ~~\$2,650~~2,700
- D. ~~\$3,900~~4,000

✓ **Answer (B) is correct.**

**Required:** The dependent's unearned income subject to parents' marginal rate.

**Discussion:** Net unearned income of a dependent child is taxed to the dependent at the higher marginal rate of the child's parent. Net unearned income is unearned income minus the sum of

1. ~~\$1,250~~1,300 (first ~~\$1,250~~1,300 clause)
2. Greater of (a) ~~\$1,250~~1,300 of the standard deduction or ~~\$1,250~~1,300 of itemized deductions or (b) the amount of allowable deductions directly connected with the production of unearned income
3. Chris's net unearned income is \$1,400 [~~\$3,900~~4,000 unearned income – (~~\$1,250~~1,300 + ~~\$1,250~~1,300 std. ded.)]

✗ **Answer (A) is incorrect.** Chris's net unearned income will be subject to the Kiddie Tax.

✗ **Answer (C) is incorrect.** Chris's unearned income is reduced by an additional ~~\$1,250~~1,300 of the standard deduction, to arrive at the net unearned income.

✗ **Answer (D) is incorrect.** Only Chris's net unearned income will be subject to the Kiddie Tax.

## Study Unit 7 – Property Transactions: Basis and Cost Recovery

Page 242, Subunit 7.1, under Uniform Capitalization Rules:

Uniform capitalization rules do not apply to producers and resellers if the company's average annual gross receipts (for the past 3 years) do not exceed ~~\$29~~30 million.

Page 246, Subunit 7.1, under Gift:

NOTE: The ~~2023~~2024 annual exclusion for gift tax purposes is \$17,000~~17,000~~18,000 per person; i.e., a donor can give a donee ~~\$17,000~~18,000 each year without paying gift tax or using a portion of their lifetime exemption.

Page 257, Subunit 7.2, under Modified Accelerated Cost Recovery System (MACRS):

For ~~2023~~2024, a deduction may be for no more than either

- The amount of ~~\$1,160,000~~1,220,000 minus the excess of Sec. 179 eligible asset acquisitions for the year over ~~\$2.89~~3.05 million (no Sec. 179 deduction if total purchase cost is above ~~\$4.05~~4.27 million) or
- Taxable income (TI) from the active conduct of any trade or business during the tax year.
  - Current-year excess over TI may be carried forward and treated as Sec. 179 cost in a subsequent year subject to the overall limitation.

### Example 7-19 Maximum Sec. 179 Deduction

In ~~2023~~2024, Diana's Corner Stores upgraded various equipment and computers at a total cost of ~~\$3,300,000~~3,520,000. All assets purchased are eligible for Sec. 179 treatment. The Sec. 179 deduction is phased out dollar for dollar once the minimum threshold for purchases is exceeded. Therefore, the maximum Sec. 179 deduction Diana's Corner Stores can take is \$750,000 [~~\$1,160,000~~1,220,000 maximum deduction – (~~\$3,300,000~~3,520,000 purchases – ~~\$2,890,000~~3,050,000 phaseout)].

Page 258, Subunit 7.2, 80% Expensing (Bonus Depreciation):

## 80% Expensing (Bonus Depreciation)

From Form 4562

### Part II Special Depreciation Allowance and Other Depreciation (Don't include listed property. See instructions.)

14 Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions.

14

There is additional first-year bonus depreciation of 80% for qualified property (including certain planted or grafted plants bearing fruits and nuts) acquired and placed in service before January 1, 2024.

- For certain property with longer production periods, the acquisition and placed-in-service period is before January 1, 2025.
- The property is eligible for the additional depreciation if it is the taxpayer's first use. This allows for the property to be new or used.
- Qualified property would not include any property used by a regulated public utility company or any property used in a real property trade or business.
- Qualifying property must be new or used MACRS property with a 20-year-or-less recovery period and must be placed into service before January 1, 2027 (before January 1, 2028, for certain property with longer production periods).
- Qualifying property includes leasehold improvements.
- The property cannot be acquired from a related party.

Any deduction for bonus depreciation is taken before the regular depreciation is recalculated.

The bonus depreciation rate is phased down in subsequent years as follows:

- ~~60% -- property placed in service after December 31, 2023, and before January 1, 2025.~~
- 40% -- property placed in service after December 31, 2024, and before January 1, 2026.
- 20% -- property placed in service after December 31, 2025, and before January 1, 2027.

NOTE: For certain property with longer production periods, the dates above are increased by 1 year as follows:

- 80% -- property placed in service after December 31, 2023, and before January 1, 2025.
- 60% -- property placed in service after December 31, 2024, and before January 1, 2026.
- 40% -- property placed in service after December 31, 2025, and before January 1, 2027.
- 20% -- property placed in service after December 31, 2026, and before January 1, 2028.

## Page 269, Subunit 7.1, Question 5:

5. In the current year, Christian received a gift of property from his mother that had a fair market value of ~~\$60,000~~ 61,000. Her adjusted basis was ~~\$20,000~~ 21,000. She paid a gift tax of \$8,600. What is Christian's basis in the property?

- A. ~~\$60,000~~ 61,000
- B. ~~\$69,000~~ 69,600
- C. ~~\$28,600~~ 29,600
- D. ~~\$28,000~~ 29,000

✓ **Answer (D) is correct.**

**Required:** The taxpayer's basis in property received by gift after the donor paid gift tax.

**Discussion:** The basis of property acquired by gift is generally the donor's adjusted basis, increased by a gift tax paid applicable to appreciation. The gift tax applicable to appreciation is the appreciation divided by the taxable gift times the gift tax paid. The annual exclusion for gift tax purposes is ~~\$17,000~~ 18,000 per person.

Donor's adjusted basis	<del>\$20,000</del> <u>21,000</u>
Gift tax *	<u>8,000</u>
	<u><del>\$28,000</del> <u>29,000</u></u>

$$\frac{\$60,000 - \$20,000}{\$60,000 - \$17,000} \times \$8,600 = \$8,000^*$$

$$\frac{\$61,000 - \$21,000}{\$61,000 - \$18,000} \times \$8,600 = \$8,000^*$$

- ✗ **Answer (A) is incorrect.** The donee's basis is the donor's adjusted basis plus a portion of the gift tax paid.
- ✗ **Answer (B) is incorrect.** The donor's adjusted basis is used, not the FMV of the gift property.
- ✗ **Answer (C) is incorrect.** Only a portion of the gift tax paid is added to the donor's basis to determine the donee's adjusted basis.

## Pages 272-274, Subunit 7.2, Questions 11, 13, and 15:

11. All of the following statements are correct regarding bonus depreciation **except**

- A. Only new property is eligible for bonus depreciation.
- B. Qualified property would not include any property used by a regulated public utility company or any property used in a real property trade or business.
- C. First-year bonus depreciation is ~~80~~ 60% for qualified property placed in service in ~~2023~~ 2024.
- D. The property cannot be acquired from a related party.

✓ **Answer (A) is correct.**

**Required:** The incorrect statement about ~~80~~ 60% expensing (bonus depreciation).

**Discussion:** Property is eligible for the additional depreciation if it is the taxpayer's first use.

- ✗ **Answer (B) is incorrect.** Qualified property would not include any property used by a regulated public utility company or any property used in a real property trade or business.
- ✗ **Answer (C) is incorrect.** First-year bonus depreciation is ~~80~~ 60% for qualified property placed in service in ~~2023~~ 2024.
- ✗ **Answer (D) is incorrect.** Property acquired from a related party does not qualify for bonus depreciation.

13. Browne, a self-employed taxpayer, had ~~2023~~2024 business taxable income of ~~\$1,100,000~~1,190,000 prior to any expense deduction for equipment purchases. In ~~2023~~2024, Browne purchased and placed into service, for business use, office machinery costing ~~\$1,175,000~~1,265,000. This was Browne's only ~~2023~~2024 capital expenditure. Browne's business establishment was not in an economically distressed area. Browne made a proper and timely expense election to deduct the maximum amount. Browne was not a member of any pass-through entity. What is Browne's deduction under the election?

- A. ~~\$1,100,000~~1,190,000
- B. ~~\$1,175,000~~1,265,000
- C. ~~\$1,160,000~~1,220,000
- D. ~~\$2,890,000~~3,050,000

15. What is the bonus depreciation rate for property with longer production periods in ~~2023~~2024?

- a. ~~80~~100%
- b. 40%
- c. 60%
- d. ~~100~~80%

✓ **Answer (A) is correct.**

**Required:** The maximum amount of Sec. 179 deduction in ~~2023~~2024.

**Discussion:** Tangible and depreciable personal property can be expensed by up to ~~\$1,160,000~~1,220,000 in ~~2023~~2024, the year of acquisition. This amount is reduced when the amount of Sec. 179 property placed in service in a given year exceeds ~~\$2,890,000~~3,050,000. Since this limit does not apply, the maximum deduction would be ~~\$1,160,000~~1,220,000; however, there are other limits. Section 179(b)(3)(A) limits the deduction to taxable income derived from the active conduct of any trade or business. In this case, the maximum deduction is ~~\$1,100,000~~1,190,000.

✗ **Answer (B) is incorrect.** The Sec. 179 deduction is limited to taxable income.

✗ **Answer (C) is incorrect.** The maximum Sec. 179 deduction of ~~\$1,160,000~~1,220,000 for ~~2023~~2024 ignores the taxable income limit.

✗ **Answer (D) is incorrect.** The amount of ~~\$2,890,000~~3,050,000 is the threshold at which the deduction is reduced dollar-for-dollar, ignoring the taxable income limit in this case.

✓ **Answer (D) is correct.**

**Required:** The bonus depreciation rate for each depreciable period.

**Discussion:** The first-year bonus depreciation is ~~80~~60% for qualified property acquired and placed in service after December 31, ~~2022~~2023, and before January 1, ~~2024~~2025. For certain properties with longer production periods, the acquisition and placed-in-service period for ~~100~~80% bonus depreciation is after ~~September 27, 2017~~December 31, 2023, and before January 1, ~~2024~~2025.

✗ **Answer (A) is incorrect.** The percentage for property with longer production periods placed in service after ~~December 31, 2023~~September 27, 2017, and before January 1, ~~2025~~2024, is ~~80~~100%.

✗ **Answer (B) is incorrect.** The percentage for property with longer production periods placed in service after December 31, 2025, and before January 1, 2027, is 40%.

✗ **Answer (C) is incorrect.** The percentage for property with longer production periods placed in service after December 31, 2024, and before January 1, 2026, is 60%.



## Study Unit 8 – Gross Income and Exclusions

Page 279, Subunit 8.1, under Compensation for Services:

The following types of income must also be included on Form W-2 and in the total on line 1 of Form 1040.

- Wages received as a household employee
  - An employer is not required to provide a Form W-2 to the taxpayer if the employer paid the taxpayer wages of less than ~~\$2,600~~ 2,700 in ~~2023~~ 2024.

Page 281, Subunit 8.1, under Taxable State and Local Refunds or Credits, Example 8-3:

### Example 8-3 Inclusion of Refunded Tax in Gross Income

In ~~2023~~ 2024, a taxpayer who files single elected to itemize deductions, claiming \$10,000 of state income tax paid and ~~\$4,900~~ 5,650 of investment interest paid for a total itemized deduction of ~~\$44,900~~ 15,650. In ~~2024~~ 2025, the state refunded \$2,000. The taxpayer must include the refund in gross income for ~~2024~~ 2025 to the extent the total ~~2023-2024~~ itemized deduction exceeded the ~~2023-2024~~ standard deduction, which is \$1,050 (~~\$44,900~~ 15,650 itemized deduction – ~~\$43,850~~ 14,600 standard deduction for ~~2023~~ 2024).

Page 299, Subunit 8.2, under Redemption of U.S. Savings Bonds to Pay Educational Expenses:

- The taxpayer's modified AGI (MAGI) must not exceed a certain limit. For ~~2023~~ 2024, the exclusion is reduced when MAGI exceeds a threshold of ~~\$91,850~~ 96,800 (~~\$137,800~~ 145,200 if a joint return). The amount at which the benefit is completely phased out is ~~\$106,850~~ 111,800 (~~\$167,800~~ 175,200 if a joint return).

Page 301, Subunit 8.2, under Foreign-Earned Income Exclusion:

U.S. citizens may exclude up to ~~\$120,000~~ 126,500 (in calendar year ~~2023~~ 2024) of foreign-earned income and statutory housing cost allowance from gross income.

- This exclusion is in lieu of the Foreign Tax Credit.
- Deductions attributed to the foreign-earned income (which is excluded) are disallowed.
- The ~~\$120,000~~ 126,500 limitation must be prorated if the taxpayer is not present in (or a resident of) the foreign country for the entire year.

## Page 309, Subunit 8.1, Question 8:

8. In ~~2023~~2024, Emil Gow won \$18,000 in a state lottery and spent \$800 for the purchase of nonwinning lottery tickets. Emil elected the standard deduction on his ~~2023~~2024 income tax return. The amount of lottery winnings that should be included in Emil's ~~2023~~2024 gross income is

- A. \$0
- B. ~~\$3,350~~2,600
- C. \$4,150
- D. \$18,000

✓ **Answer (D) is correct.**

**Required:** The amount of state lottery winnings included in gross income.

**Discussion:** Gambling winnings (whether legal or illegal) are included in gross income.

Therefore, Emil must include the full \$18,000 in gross income. Gambling losses, i.e., amounts spent on nonwinning tickets, may be deductible but only as an itemized deduction to the extent of gambling winnings.

✗ **Answer (A) is incorrect.** All gambling winnings constitute gross income.

✗ **Answer (B) is incorrect.** If the standard deduction is claimed, itemized deductions are not allowed. In addition, the standard deduction reduces AGI, not the amount included in gross income.

✗ **Answer (C) is incorrect.** Although gambling losses are an itemized deduction, they do not reduce the amount of gambling winnings included in gross income.

## Study Unit 9 – General Business Earnings and Employment Taxes

Page 318, Subunit 9.1, under Cost of Goods Sold:

- This rule does not apply to small business taxpayers.
  - The taxpayer qualifies as a small business taxpayer if the taxpayer has average annual gross receipts of \$~~29~~30 million or less for the 3 prior tax years.

Page 323, Subunit 9.1, under Automobile Expenses:

Actual expenses for an automobile used for business purposes are deductible (e.g., services, repairs, gas) by all business organizations. Alternatively, **sole proprietors** may deduct the standard mileage rate of \$~~0.655~~0.67 per mile for ~~2023~~2024.

Page 323, Subunit 9.1, under Insurance Expense, Example 9-5:

### Example 9-5 Deductible Insurance Premiums

In ~~2023~~2024, the business signed a 3-year insurance contract. Even though the business paid the premiums for ~~2023, 2024, and 2025~~, and 2026 when the business signed the contract, the business can only deduct the premium for ~~2023~~2024 on the ~~2023~~2024 tax return. The business can deduct in ~~2024~~2025 and ~~2025~~2026 the premiums allocable to those years.

Page 326, Subunit 9.2, under Federal Insurance Contributions Act (FICA) – Social Security & Medicare Taxes:

The **employer** must pay and is able to deduct

- 6.2% of the first \$~~160,200~~168,600 (~~2023~~2024) of wages paid for Social Security (i.e., OASDI) tax, plus
- 1.45% of all wages for Medicare tax. There is no cap on this tax.

The employer must withhold the following amounts from the **employee's** wages:

- Tier 1 – From \$0 to \$~~160,200~~168,600; Employee's wages × 7.65% (6.2% Social Security + 1.45% Medicare)
- Tier 2 – Above \$~~160,200~~168,600 to \$200,000; Employee's wages × 1.45% (Medicare)
- Tier 3 – Above \$200,000 of earned income; Employee's wages × 2.35% (1.45% Medicare + 0.9% Additional Medicare)
  - The Additional Medicare Tax on earned income is a 0.9% tax on wages and net self-employment income in excess of a threshold.
  - This additional tax applies to earned income exceeding \$200,000 for single, head-of-household, or surviving spouse; \$250,000 for married filing jointly; and \$125,000 for married filing separately. Employers withhold an additional 0.9% for income beyond \$200,000 regardless of filing status.

An employer must pay FICA taxes for all household employees who are paid more than \$~~2,600~~2,700 during tax year ~~2023~~2024.

## Page 329, Subunit 9.1, Question 7:

6. In January 2023~~2023~~<sup>2024</sup>, Mr. D, who is self-employed, purchased a new automobile, which he uses 100% for business. During 2023~~2023~~<sup>2024</sup>, he drove the car 14,000 miles. Mr. D also owns another automobile, which he uses occasionally for business but primarily for personal purposes. During 2023~~2023~~<sup>2024</sup>, he drove the second car 2,000 business miles. The second car is not fully depreciated. Assume both vehicles were driven uniformly throughout the year. What is the amount of Mr. D's automobile expense deduction using the standard mileage rate?

- A. \$9,170~~9,380~~
- B. \$7,840~~8,960~~
- C. \$9,360
- D. \$10,480~~10,720~~

✓ **Answer (D) is correct.**

**Required:** The allowable automobile expense deduction using the standard mileage rate.

**Discussion:** Automobile expenses pertaining to a trade or business are deductible under Sec. 162 as ordinary and necessary business expenses. The taxpayer may either deduct the portion of actual operating cost of the automobile attributed to business use or compute the deduction based on the standard mileage rate. For 2023~~2023~~<sup>2024</sup>, the standard mileage rate is \$0.655~~567~~<sup>67</sup> per mile for all miles of business use. Mr. D's deduction for 2023~~2023~~<sup>2024</sup> is \$10,480~~10,720~~ (\$16,000 miles × \$0.655~~567~~<sup>67</sup>). The standard mileage rate is adjusted annually by the IRS to the extent warranted.

- ✗ **Answer (A) is incorrect.** The business mileage on the second car should also be deducted.
- ✗ **Answer (B) is incorrect.** The standard mileage rate for 2021 is \$0.56. In addition, this amount excludes the deductible miles of the second car.
- ✗ **Answer (C) is incorrect.** The amount of automobile expense deduction using the standard mileage rate for January-June 2022 is \$9,360. The rate was increased on July 1, 2022, and January 1, 2023. Additionally, the vehicles were driven uniformly throughout the year.

## Page 333, Subunit 9.2, Question 13:

13. Ernesto was an employee of Med-Tech Corporation for all of 2023~~2023~~<sup>2024</sup>. He earned \$162,200~~170,600~~ in salary. What is the amount of FICA tax paid by Med-Tech Corporation with respect to Ernesto?

- A. \$9,932~~10,453~~
- B. \$12,255~~12,898~~
- C. \$12,284~~12,927~~
- D. \$12,408~~13,051~~

✓ **Answer (C) is correct.**

**Required:** The Social Security taxes required to be paid by an employer in 2023~~2023~~<sup>2024</sup>.

**Discussion:** Only the OASDI (old-age, survivors, and disability insurance) component of the FICA tax has a wage ceiling. The OASDI rate is 6.20% for employers up to a maximum of \$160,200~~168,600~~ (in 2023~~2023~~<sup>2024</sup>). For the Medicare component, which has no wage ceiling, the rate is 1.45% for employers and employees. The employment taxes paid by Med-Tech with respect to Ernesto in 2023~~2023~~<sup>2024</sup> are as follows:

OASDI	\$160,200 <del>168,600</del> × 0.0620 =	\$ 9,932 <del>10,453</del>
Medicare	\$162,200 <del>170,600</del> × 0.0145 =	2,352 <del>2,474</del>

Total		\$12,284 <del>12,927</del>
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- ✗ **Answer (A) is incorrect.** The amount of \$9,932~~10,453~~ is only the OASDI portion of the Social Security tax.
- ✗ **Answer (B) is incorrect.** The Medicare portion of the tax is not limited to \$160,200~~168,600~~ of wages.
- ✗ **Answer (D) is incorrect.** The OASDI portion of the Social Security tax is applied only to a maximum of \$160,200~~168,600~~ of wages. The Medicare portion has no limit.

## Study Unit 10 – Adjustments and Deductions from AGI

Page 338, Subunit 10.1, under Health Savings Account Deduction:

The amount that may be contributed to a taxpayer's Health Savings Account depends on the nature of his or her coverage and his or her age.

- For self-only coverage, the taxpayer or his or her employer can contribute up to ~~\$3,850~~ \$4,150 (~~\$4,850~~ \$5,150 for taxpayers who have reached age 55).
- For family coverage, the taxpayer or his or her employer can contribute up to ~~\$7,750~~ \$8,300 (~~\$9,950~~ \$10,300 for taxpayers who have both reached age 55).

Page 339, Subunit 10.1, under Self-Employment Expenditures:

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### Self-Employment Expenditures

#### Self-Employment Tax

A self-employed person is allowed a deduction for the employer's portion of the FICA taxes paid to arrive at his or her AGI. The deduction for the employer's share is equal to 50% of the self-employment tax. For ~~2023~~ 2024, the deduction equals

- 6.2% of the first ~~\$160,200~~ \$168,600 of net earnings from self-employment plus
- 1.45% of net earnings from self-employment (no cap).

The 0.9% additional Medicare tax is on the employee's portion of FICA taxes. Therefore, the 0.9% tax is not deductible.

#### Self-Employed SEP, SIMPLE, and Qualified Plans

A self-employed individual can deduct specified amounts paid on his or her behalf to a qualified retirement or profit-sharing plan, such as a SEP plan.

The most common self-employed retirement plan used is a SEP plan.

The maximum annual contribution is limited to the lesser of 25% of the self-employed earnings or ~~\$66,000~~ \$69,000 in ~~2023~~ 2024.

[ . . . ]

Another option for a self-employed taxpayer is a Savings Incentive Match Plan for Employees (SIMPLE).

- Self-employed taxpayers may make both employer contributions and elective employee contributions.
- Employee contributions are considered deferred compensation and are limited to ~~\$15,500~~ \$16,000 in ~~2023~~ 2024.
- An employer match of up to 3% of self-employed earnings may be deducted.

Pages 340-341 and 343, Subunit 10.1, under IRA Deduction:

## IRA Deduction

### Individual Retirement Arrangement (IRA) Contributions (Traditional IRAs)

For ~~2023~~2024, contributions are fully deductible (subject to certain qualifying rules and limitations) up to the lesser of ~~\$6,500~~7,000 (~~\$7,500~~8,000 for taxpayers age 50 and over) or 100% of includible compensation. Because contributions are deducted from gross income, all distributions are included as ordinary gross income.

To qualify for the return year, contributions must be made by the due date of the return without regard to extensions.

Compensation includes alimony and earned income but not pensions, annuities, or other deferred compensation distributions.

An additional ~~\$6,500~~7,000 (~~\$7,500~~8,000 for taxpayers age 50 and over) may be contributed to the IRA for the taxpayer's nonworking spouse, or a spouse earning less income, if a joint return is filed.

- The combined IRA contributions by both spouses cannot exceed their combined compensation for the year.

If the taxpayer is an active participant in an employer-sponsored retirement plan and has earned income of over ~~\$116,000~~123,000 (married filing jointly or qualifying surviving spouse) in ~~2023~~2024 (~~\$73,000~~77,000 in ~~2023~~2024 for head of household or single taxpayers, and \$0 for married filing separate), the IRA deduction is proportionately reduced over a phaseout range (fully phased out at ~~\$136,000~~143,000 MFJ and ~~\$83,000~~87,000 Single/HH).

- An individual is not labeled an active plan participant due to the status of that individual's spouse.
- If an individual's spouse is an active plan participant, that individual's deductible contribution will be phased out when AGI is between ~~\$218,000~~230,000 and ~~\$228,000~~240,000.

Excessive contributions may be subject to a 6% excise tax.

The owner of an IRA must begin receiving distributions by April 1 of the calendar year following the later of the calendar year in which the employee attains age 73 or the calendar year in which the employee retires.

If distributions are less than the required minimum distributions for the year, a 25% excise tax will be imposed on the amount not distributed.

Contributions can still be made to an IRA (up to the ~~\$6,500~~7,000/~~\$7,500~~8,000 limits) even if nondeductible. This is often called a nondeductible IRA. Because there is no deduction upon contribution, and because earnings are taxed upon withdrawal, the nondeductible IRA is less advantageous than a deductible IRA or a Roth IRA. But, like a traditional IRA, a nondeductible IRA does allow earnings to grow tax-free until withdrawal.

[...]

## Roth IRAs and Roth 401(k)s

[...]

The overall limit for contributions to IRAs, both traditional and Roth, is ~~\$6,500~~ 7,000 (~~\$7,500~~ 8,000 for taxpayers age 50 and over).

Contributions to Roth IRAs are phased out based on AGI (i.e., you cannot contribute to a Roth above these phaseouts):

	2023 2024 AGI Phaseout Range
MFJ	<del>\$218,000</del> <u>230,000</u> to <del>\$228,000</del> <u>240,000</u>
Single, HH	<del>\$138,000</del> <u>146,000</u> to <del>\$153,000</del> <u>161,000</u>
MFS	\$0 to \$10,000

Page 343, Subunit 10.1, under Student Loan Interest Deduction:

The deduction is subject to income limits.

	AGI Phaseout Range
MFJ	<del>\$155,000</del> <u>165,000</u> to <del>\$185,000</del> <u>195,000</u>
Single, HH, MFS	<del>\$75,000</del> <u>80,000</u> to <del>\$90,000</del> <u>95,000</u>

The amount of reduction in the deduction can be calculated as follows:

$$\$2,500 \times \frac{(\text{AGI} - \text{\$75,000} \text{ } 80,000)}{\$15,000 \text{ phaseout range}}$$

Page 345, Subunit 10.2, under Taxable Income, Standard Deduction:

## Standard Deduction

STANDARD DEDUCTION AMOUNTS -- <del>2023</del> 2024		
Filing Status	Basic	Additional Age 65/Blind
Married Filing Jointly (MFJ)	<del>\$27,700</del> <u>29,200</u>	<del>\$1,500</del> <u>1,550</u>
Qualifying Surviving Spouse	<del>27,700</del> <u>29,200</u>	<del>1,500</del> <u>1,550</u>
Head of Household (HH)	<del>20,800</del> <u>21,900</u>	<del>1,850</del> <u>1,950</u>
Single (other than above)	<del>13,850</del> <u>14,600</u>	<del>1,850</del> <u>1,950</u>
Married Filing Separately (MFS)	<del>13,850</del> <u>14,600</u>	<del>1,500</del> <u>1,550</u>

The standard deduction is the sum of the basic standard deduction and the additional standard deductions.

The **basic standard deduction** amount depends on filing status and dependency status on another's return.

- The basic standard deduction amount of a child under age 19 or a student under age 24 who can be claimed as a dependent on another individual's income tax return is limited to the greater of either
  - ~~\$1,250~~ 1,300 or
  - Earned income for the year plus ~~\$400~~ 450 up to ~~\$13,850~~ 14,600 (i.e., applicable single standard deduction).
    - ▶ Earned income does not include either dividends or capital gains from the sale of stock.

Page 358, Subunit 10.3, under Qualifying Business Income (QBI), Taxable Income Thresholds:

## Taxable Income Thresholds

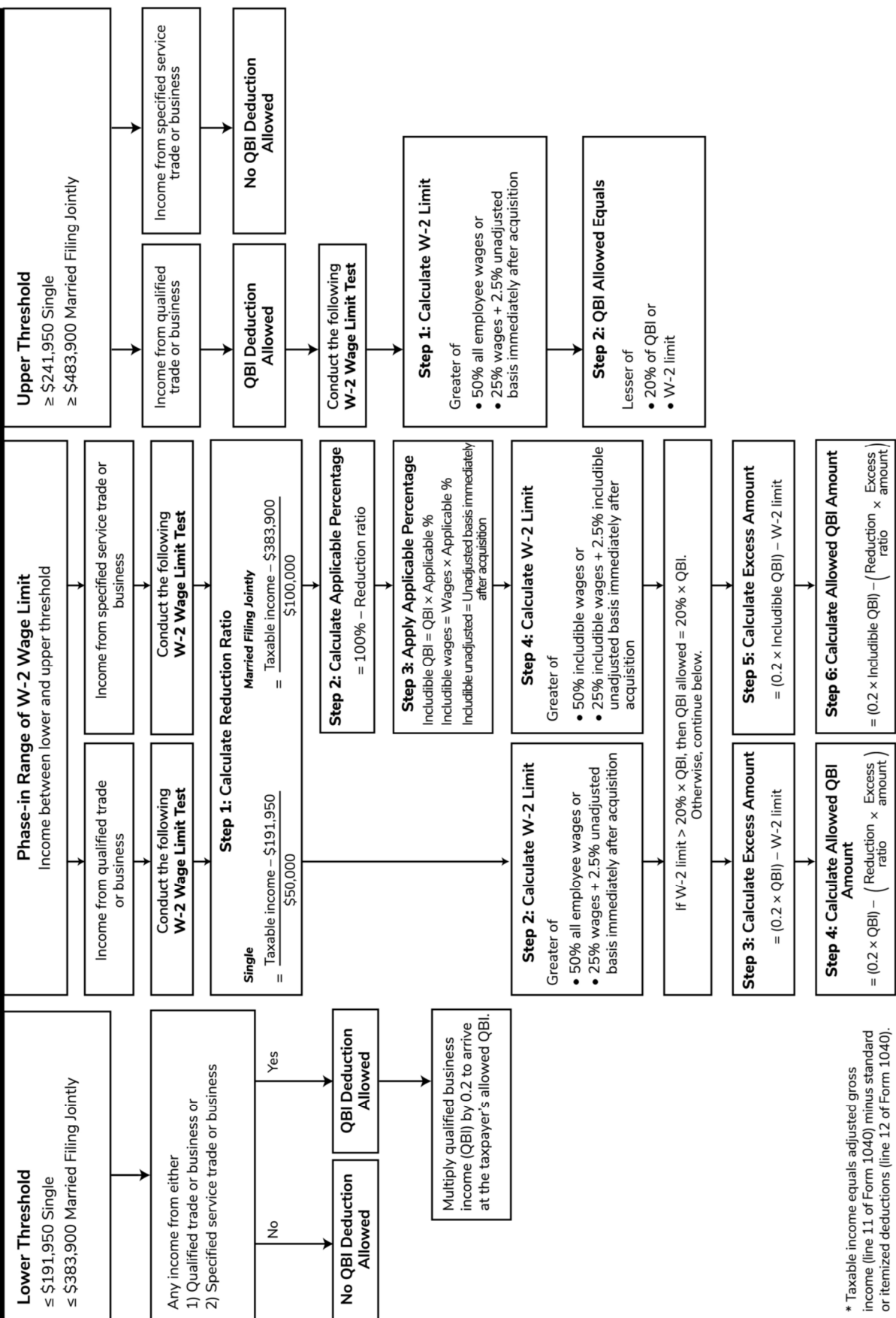
QBID limitations apply when the taxable income reaches the threshold. For ~~2023~~ 2024, the lower threshold is ~~\$364,200~~ 383,900 for married filing jointly taxpayers and ~~\$182,100~~ 191,950 for single filers. The upper threshold is ~~\$464,200~~ 483,900 for married filing jointly taxpayers and ~~\$232,100~~ 241,950 for single filers.

Pages 359-360, Subunit 10.3, under Qualifying Business Income (QBI), Wages and Property Limitations: The amounts in Figure 10-1 were edited. Rather than showing the individual amounts that changed, the full new version of the figure is reproduced on the next page.



# QUALIFIED BUSINESS INCOME DEDUCTION

## Taxable Income\*



\* Taxable income equals adjusted gross income (line 11 of Form 1040) minus standard or itemized deductions (line 12 of Form 1040).

**Example 10-10 SSTB Limitation Phase-In**

Earl, a single taxpayer, has taxable income of ~~\$217,100~~ 226,950. Thus, he is subject to the specified service business limitation and the wages and property limitation. Earl has \$100,000 of business income that would be QBI but for the fact it was generated by a specified service business. However, because Earl's taxable income is in the phase-in range, he will be eligible for a partial QBID. Assuming Earl is not also limited by the wages and property limitation, his partial deduction would be computed as follows:

$$\frac{\$217,100 - \$182,100}{\$50,000} = 70\% \text{ reduction ratio}$$

$$(1 - 70\%) \times \$100,000 = \$30,000 \text{ of QBI}$$

$$\$30,000 \times 20\% = \$6,000 \text{ QBID}$$

**Example 10-11 Wage and Property Limitation Phase-In**

Fran, a single taxpayer, has taxable income of ~~\$197,100~~ 206,950. Thus, she is subject to the wages and property limitation. Fran has \$100,000 of QBI (not from a specified service business). However, Fran only has allocable W-2 wages of \$30,000 and no qualifying property. Because Fran's taxable income is in the phase-in range, the wage and property limitation will be phased in. Fran's deduction is computed as follows:

$$\frac{\$197,100 - \$182,100}{\$50,000} = 30\% \text{ reduction}$$

Thus, any wage and property limitation will be phased in by 30%. In other words, only 30% of any limitation computed will apply. Therefore, Fran's tentative QBID is \$20,000 (\$100,000 × 20%). However, under the wage and property limitation, her deduction would be limited to \$15,000, a limitation (decrease) of \$5,000. However, because Fran is in the phase-in range, only 30% of this limitation will apply. Thus, Fran's QBID is \$18,500 [\$20,000 – (\$5,000 × 30%)].

## Page 362, Subunit 10.1, Question 2:

2. In the current year, an unmarried individual with modified adjusted gross income of \$25,000 paid \$1,000 interest on a qualified education loan entered into on July 1. How may the individual treat the interest for income tax purposes?

- A. As a \$500 deduction to arrive at AGI for the year.
- B. As a \$1,000 deduction to arrive at AGI for the year.
- C. As a \$1,000 itemized deduction.
- D. As a nondeductible item of personal interest.

✓ **Answer (B) is correct.**

**Required:** The treatment of interest paid for qualified higher education loans.

**Discussion:** Taxpayers may deduct up to \$2,500 of interest paid on qualified educational loans. The deduction is subject to income limits. The phaseout range begins when AGI exceeds \$75,000 and ends at \$90,000 for unmarried individuals and ends at \$95,000. The \$1,000 interest payment is deducted from income to arrive at \$24,000 AGI for the year.

- ✗ **Answer (A) is incorrect.** The reduction in the deduction does not begin until AGI exceeds \$75,000.
- ✗ **Answer (C) is incorrect.** The deduction is taken as an adjustment to income from Schedule 1 on Form 1040 to arrive at AGI for the year.
- ✗ **Answer (D) is incorrect.** Taxpayers may take a deduction up to \$2,500 of interest paid on qualified educational loans.

## Page 366, Subunit 10.2, Question 13:

13. Anna is a 22-year-old student with earned income of \$11,300 and dividend income of \$1,250. Her parents claim her as a dependent on their tax return. What is Anna's basic standard deduction amount?

- A. \$1,250
- B. \$11,700
- C. \$12,550
- D. \$13,850

✓ **Answer (B) is correct.**

**Required:** The basic standard deduction amount of a student under age 24 who is claimed as a dependent on another's income tax return.

**Discussion:** The basic standard deduction amount of a student under age 24 who is claimed as a dependent on another individual's income tax return is limited to the greater of either \$1,250 or the dependent's earned income for the year plus \$400 up to the otherwise applicable basic standard deduction amount. Earned income does not include either dividends or capital gains from the sale of stock. Since Anna's earned income of \$11,300 exceeds \$1,250 and is less than the otherwise applicable standard deduction amount of \$13,850, Anna's applicable standard deduction is \$11,700 (\$11,300 earned income + \$400).

- ✗ **Answer (A) is incorrect.** Anna is entitled to a basic standard deduction amount that is limited to the greater of either \$1,250 or her earned income plus \$400.
- ✗ **Answer (C) is incorrect.** The basic standard deduction amount of a student under age 24 who is claimed as a dependent on another individual's income tax return is limited to the greater of either \$1,250 or the dependent's earned income for the year plus \$400 up to the otherwise applicable basic standard deduction amount. Thus, Anna's basic standard deduction is limited to her \$11,300 earned income plus \$400. Dividends are not earned income.
- ✗ **Answer (D) is incorrect.** The standard deduction amount for an unmarried individual is \$13,850. Anna does not use this amount since she can be claimed by her parents as a dependent on their tax return.

## Pages 368-370, Subunit 10.3, Questions 17 and 19-20:

17. Which of the following comments is **not** correct regarding the QBI deduction?

- A. Taxpayers with taxable income above the lower threshold are subject to limitations based on W-2 wages and/or the unadjusted basis in acquired qualified property.
- B. For the most part, the deduction is 21% of a taxpayer's QBI from a partnership, S corporation, or sole proprietorship.
- C. The QBI deduction is available to taxpayers who elect the standard deduction.
- D. The W-2 wage limit begins to phase in if the taxpayer's taxable income exceeds the threshold amount of \$182,100 (\$364,200 for a joint return).

✓ **Answer (B) is correct.**

**Required:** The incorrect statement about QBID.

**Discussion:** Generally, the deduction is 20%, not 21%, of a taxpayer's QBI from a partnership, S corporation, or sole proprietorship. The deduction is intended to reduce the tax rate on QBI to a rate that is closer to the corporate tax rate of 21%.

- ✗ **Answer (A) is incorrect.** Based on taxable income, taxpayers may be subject to limitations based on the W-2 wages and the unadjusted basis in acquired qualified property.
- ✗ **Answer (C) is incorrect.** The QBI deduction is available to taxpayers who elect the standard deduction.
- ✗ **Answer (D) is incorrect.** The W-2 wage limit begins to phase in if the taxpayer's taxable income exceeds the threshold amount of ~~\$182,100~~ \$191,950 (~~\$364,200~~ \$383,900 for a joint return).

19. Forrest, a single taxpayer, has taxable income of ~~\$337,000~~ \$347,000. He considers investing in some entities to earn extra income. In which of the following entities should Forrest invest so that he may be able to claim the Sec. 199A deduction?

- A. A tax services partnership.
- B. A limited liability partnership that performs brokerage services.
- C. An S corporation that performs architecture services.
- D. A C corporation that performs engineering services.

✓ **Answer (C) is correct.**

**Required:** The qualified business for QBID.

**Discussion:** Because Forrest has taxable income greater than ~~\$232,100~~ \$241,950, only investing in qualified businesses enables him to claim a Sec. 199A deduction (i.e., non-SSTB). A qualified trade or business is any trade or business other than a specified service trade or business and other than the trade or business of performing services as an employee. A "specified service trade or business" under Sec. 199A includes any trade or business that involves the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, and brokerage services. "Specified service activity" is modified to exclude engineering and architecture services under Sec. 199A. In addition, an S corporation is a qualified pass-through entity. Thus, Forrest should invest in an S corporation that performs architecture services so that he may be able to claim the Sec. 199A deduction.

- ✗ **Answer (A) is incorrect.** A tax services partnership is a specified service trade or business that disqualifies Forrest from taking the Sec. 199A deduction because his taxable income is greater than ~~\$232,100~~ \$241,950.
- ✗ **Answer (B) is incorrect.** A limited liability partnership that performs brokerage services is a specified service trade or business that disqualifies Forrest from taking the Sec. 199A deduction because his taxable income is greater than ~~\$232,100~~ \$241,950.
- ✗ **Answer (D) is incorrect.** The Sec. 199A deduction is available to noncorporate taxpayers who have qualified business income from qualified pass-through entities. Qualified pass-through entities include sole proprietorships, S corporations, partnerships, trusts, and estates. A C corporation is not a qualified pass-through entity. Thus, Forrest cannot claim the Sec. 199A deduction if he chooses to invest in a C corporation.

20. Amy and Tyler are married and have taxable income of ~~\$425,000~~ 445,000. Amy has a sole proprietorship that is a specified service trade or business. Under Sec. 199A, which of the following statements is true based on the above information?

- A. Amy and Tyler cannot claim the Sec. 199A deduction because the sole proprietorship is a qualified trade or business.
- B. Amy and Tyler can claim the Sec. 199A deduction because the sole proprietorship is a qualified trade or business.
- C. Amy and Tyler can claim the Sec. 199A deduction and deduct 20% of qualified business income (QBI) for the proprietorship because the W-2 wages/qualified property limit does not apply.
- D. Amy and Tyler can claim the Sec. 199A deduction, but the applicable percentage of qualified items of income, gain, deduction, or loss; the W-2 wages; and the unadjusted basis of qualified property allocable to the business should be taken into account in the calculations.

✓ **Answer (D) is correct.**

**Required:** The true statement about qualified businesses and trades.

**Discussion:** Because Amy and Tyler have taxable income of less than ~~\$464,200~~ 483,900 and more than ~~\$364,200~~ 383,900, the applicable percentage of qualified items of income, gain, deduction, or loss; the W-2 wages; and the unadjusted basis of qualified property of the taxpayer allocable to the business shall be taken into account.

- ✗ **Answer (A) is incorrect.** The sole proprietorship is not a qualified trade or business. Additionally, even though the sole proprietorship is not a qualified trade or business, Amy and Tyler can claim the Sec. 199A deduction because their taxable income of ~~\$425,000~~ 445,000 is less than ~~\$464,200~~ 483,900.
- ✗ **Answer (B) is incorrect.** A qualified trade or business is any trade or business other than a specified service trade or business and other than the trade or business of performing services as an employee. Thus, this sole proprietorship is not a qualified trade or business.
- ✗ **Answer (C) is incorrect.** When a taxpayer who is engaged in a specified service trade or business has taxable income of less than ~~\$364,200~~ 383,900 if married filing jointly (~~\$182,100~~ 191,950 for all other taxpayers), the taxpayer simply deducts 20% of QBI because the W-2 wage/qualified property limit does not apply. However, Amy and Tyler's taxable income is more than the ~~\$364,200~~ 383,900 threshold but less than the upper threshold of ~~\$464,200~~ 483,900, and the W-2 wage/qualified property limit does apply.

## Study Unit 11 – Federal Taxation of Individuals

Page 377, Subunit 11.1, under Net Operating Loss (NOL), Example 11-3:

### Example 11-3 NOL

For ~~2023~~ 2024, Sally realized a \$30,000 net loss (sales of \$200,000 less expenses of \$230,000) from operating a sole proprietorship without regard to dispositions of property other than inventory. Other than this, the income tax return showed gross income of \$10,000 (\$4,500 of wages, \$1,000 interest on personal savings, and a \$4,500 long-term capital gain on business property). The excess of deductions over income was ~~\$33,850~~ 34,600 (\$10,000 gross income – \$30,000 loss from business operations – ~~\$13,850~~ 14,600 standard deduction).

To compute Sally's NOL, add back the ~~\$42,850~~ 13,600 excess of nonbusiness deductions over nonbusiness income (~~\$13,850~~ 14,600 standard deduction – \$1,000 interest).

Thus, Sally's NOL for the current tax year is \$21,000 [~~(\$33,850)~~ 34,600 "negative taxable income" + ~~\$12,850~~ 13,600].

## Page 382, Subunit 11.1, under Excess Business Loss:

Excess business losses are calculated as the sum of all deductions from trades or businesses minus gross income or gains from trades or businesses plus ~~\$289,000~~ \$305,000 (~~\$578,000~~ \$610,000 MFJ) floor indexed annually for inflation.

### Example 11-8 Excess Business Loss

Joan, a single taxpayer, has ~~\$989,000~~ \$995,000 of deductions related to her business and \$400,000 of gross income. Her excess business loss is calculated as ~~\$300,000~~ \$290,000 (~~\$989,000~~ \$995,000 deductions minus ~~\$689,000~~ \$705,000 (\$400,000 gross income + ~~\$289,000~~ \$305,000 floor). The ~~\$300,000~~ \$290,000 excess business loss is treated as a NOL and thus limited to 80% of the future year's taxable income.

## Pages 384-385, Subunit 11.2, under Self-Employment Tax:

### Self-Employment Tax

Self-employment taxes are paid through estimated payments, not withholding.

The FICA tax liability is imposed on net earnings from self-employment at the employer rate plus the employee rate as follows:

- Tier 1 – From \$0 to ~~\$160,200~~ \$168,600: Net earnings from self-employment × 15.3%
- Tier 2 – Above ~~\$160,200~~ \$168,600 to \$200,000: Net earnings from self-employment × 2.9%
- Tier 3 – Above \$200,000 (\$250,000 MFJ, \$125,000 MFS): Net earnings from self-employment × 3.8% (2.9% Medicare + 0.9% additional Medicare)

[...]

A self-employed person is allowed a deduction for the employer's portion of the FICA taxes paid to arrive at his or her AGI. For ~~2023~~ 2024, this equals

- 6.2% of the first ~~\$160,200~~ \$168,600 of net earnings from self-employment plus
- 1.45% of net earnings from self-employment (no cap).

## Page 389, Subunit 11.1, Question 4:

4. Destry, a single taxpayer, age 35, reported the following on his ~~2023~~2024 Form 1040, U.S. Individual Income Tax Return:

Income:

Wages	\$ 5,000
Interest on savings account	1,000
Net rental income	4,000

Deductions:

Standard deduction	<del>\$13,850</del> <u>14,600</u>
Net business loss	16,000
Net short-term capital loss	2,000

What is Destry's net operating loss?

- A. \$7,000
- B. \$9,000
- C. \$20,850
- D. \$16,000

✓ **Answer (A) is correct.**

**Required:** The net operating loss.

**Discussion:** A net operating loss is defined as the excess of allowable deductions (as modified) over gross income. An NOL generally includes only items which represent business income or loss. Personal casualty losses and wage or salary income are included as business items. Nonbusiness deductions in excess of nonbusiness income must be excluded. Interest and dividends are not business income.

Net business loss	\$(16,000)
Wages	5,000
Net rental income	4,000
Net operating loss	<u><u>\$ (7,000)</u></u>

The nonbusiness capital loss cannot be deducted. The nonbusiness deductions (the standard deduction) exceed the nonbusiness income (interest), and both items are excluded from the NOL calculation.

- ✗ **Answer (B) is incorrect.** The nonbusiness capital loss cannot offset business income.
- ✗ **Answer (C) is incorrect.** The standard deduction exceeds the nonbusiness income and is excluded from the NOL calculation.
- ✗ **Answer (D) is incorrect.** The business loss must be reduced by the wages and net rental income, which are also business items.

## Page 396, Subunit 11.2, Question 20:

20. In ~~2023~~2024, Mr. K had ~~\$141,600~~120,000 in wages subject to Social Security tax and \$50,600 in net earnings from self-employment. What is the amount of K's self-employment tax for ~~2023~~2024 (rounded to the nearest dollar)?

- A. \$7,436
- B. \$7,494
- C. \$7,742
- D. ~~\$24,817~~26,102

✓ **Answer (B) is correct.**

**Required:** The self-employment tax of a person who earned wages as an employee in ~~2023~~2024.

**Discussion:** For ~~2023~~2024, the self-employment tax is separated into two components: Social Security and Medicare. The Social Security tax is 12.4% of the first ~~\$160,200~~168,600 (~~2023~~2024) of self-employment income. The Medicare tax is 2.9% of all self-employment income (no ceiling applies). In computing the self-employment tax, taxpayers may reduce the net income from self-employment by the employer's portion of the self-employment tax rate times the net income from self-employment (before this adjustment) to arrive at net earnings from self-employment. Such an adjustment has been made in arriving at the \$50,600 amount. Mr. K's employment taxes on wages of ~~\$141,600~~120,000 have already been paid through withholding by his employer. Therefore, he must pay the Social Security portion of the self-employment tax on \$48,600 (~~\$160,200~~168,600 - ~~\$141,600~~120,000). He must pay Medicare tax on the full \$50,600. Mr. K's self-employment tax is thus \$7,494 [ $(\$48,600 \times 12.4\%) + (\$50,600 \times 2.9\%)$ ].

✗ **Answer (A) is incorrect.** The amount of \$7,436 is the 15.3% self-employment tax rate times the \$48,600 of net self-employment earnings needed to reach the ~~\$160,200~~168,600 ceiling on the Social Security portion of the self-employment tax.

✗ **Answer (C) is incorrect.** A two-step calculation is applied to determine the tax, instead of the flat 15.3% rate that was used.

✗ **Answer (D) is incorrect.** Mr. K's employment taxes on wages of ~~\$141,600~~120,000 have already been paid through withholding by his employer. The 12.4% Social Security rate applies only to the first \$48,600 of net self-employment earnings needed to reach the ~~\$160,200~~168,600 ceiling on the Social Security portion of the self-employment tax, while the 2.9% rate applies to the entire net earnings from self-employment.



## Study Unit 12 – C Corporations

Page 408, Subunit 12.2, under Interest Expense:

- The deduction limitation does not apply to small businesses with average gross receipts of \$2930 million or less.

## Study Unit 13 – Flow-Through Entities and Book-to-Tax Differences

Page 459, Subunit 13.3, under Contributed Property – Partnership's Basis:

### Contributed Property – Partnership's Basis

The partnership's basis in contributed property is equal to the contributing partner's AB in the property immediately before contribution, and is increased by any gain recognized by the partner at the time of contribution. It is not adjusted for liabilities.

Page 483, Subunit 13.3, Question 12:

12. On January 2, Year 1, Black acquired a 50% interest in New Partnership by contributing property with an adjusted basis of \$7,000 and a fair market value of \$9,000, subject to a mortgage of \$3,000. What was Black's basis in New at January 2, Year 1?

- A. \$3,500
- B. \$4,000
- C. \$5,500
- D. \$7,500

✓ **Answer (C) is correct.**

**Required:** The partner's basis in a partnership when property subject to a liability is contributed.

**Discussion:** The basis of an interest in a partnership acquired by the contribution of property is the adjusted basis of such property to the contributing partner. A decrease in a partner's individual liabilities by reason of the assumption by the partnership of such liabilities is treated as a distribution of money to the partner, which in turn reduces the basis of the partner's interest (but not below zero). ~~When Black became a partner, he was relieved of 50% of the \$3,000 liability, or \$1,500. Thus, Black's basis in his or her interest in New is \$5,500 (\$7,000 – \$1,500).~~

+ AB of property contributed	\$7,000
+ Share of partnership liabilities (\$3,000 × 50%)	1,500
-- Partner's liability assumed by partnership	(3,000)
= Basis in partnership interest	\$5,500

- ✗ **Answer (A) is incorrect.** The amount of \$3,500 incorrectly allocates Black's partnership interest to the adjusted basis of contributed property.
- ✗ **Answer (B) is incorrect.** The amount of \$4,000 applies the entire mortgage against basis instead of the amount assumed by the partnership (100% – 50% interest).
- ✗ **Answer (D) is incorrect.** The amount of \$7,500 incorrectly uses the FMV of the property contributed instead of the adjusted basis.