Tax Planning

Name

Course

Institution

To: John S.
Jane S.

From: Maria F.

Date: August 23, 2018

Subject: Tax Planning 2017

This memorandum is aimed to equip you with facts about the income tax and the possible ways that can be formulated to minimize the tax liabilities. The memorandum explains deeply the various tax laws in relation to the taxable income you have received. Also included are the recommendations to assist in choosing the right investment.

John Smith Tax Issues

1a) The congress has the mandate to tax all types of income disregarding the source. The internal revenue code, otherwise known as title 26, has been published into the United States' gazette. Despite the facts that some states do not have an income tax, all the citizens and residents of the United States are subjected to the federal income tax. According to Section 61

(1) (a), Gross income refers to any type of income from whatever source including but not limited to the following:

- Service compensations which includes fees, fringe benefits, commissions
- Gross income being generated from businesses

- Interests
- Rents
- Dividends
- Annuities

Like individuals, corporations also file income tax returns. These corporations are subjected to the same rules and regulations as individuals.

The $300,000 income is categorized under service compensations. It thus will be subjected to a tax rate of 10% t0 35%. According to Sec 111 (a), the $25000 is treated as income under the tax benefits rule (which states that if the taxpayer recovers amount of money deducted in the previous year, then the amount will be included in income in the year recovered so long as deduction was allowed in the previous years). This implies that all the expenses which are incurred in the current year are deductible. For the expenditure to be classified as business expense, it must satisfy the following criteria. It must be ordinary and necessary, it must be reasonable, and must be paid during the taxable year.

Jane Smith Tax Issues

2a) If the tax deductions are itemized, then a new mortgage has benefits since it gives you significant tax deductions. Despite this, there is an interest deducted up to a maximum of one million USD from the taxable income. On the contrary, when financing a mortgage payment only a small portion of the money is used in reducing the loan balance, while the rest is used to pay off the interest. Thus, it assumes that new mortgage is advantageous as compared to paying down the mortgage.

2b) Capital gains can be achieved when the current home is paid off and a new home is bought. This gain can be up to $500,000, according to Sec 121(a) (b) (1) (2) (A). According to internal revenue code (Sec 121), realized gains exceeding $500,000 filing joint or $250,000 filing separate is subjected to capital gains tax. The repeal of sec 1034 denies taxpayers to defer gains by purchasing a home costing equally or more than the sale of their old home (Smith, 2013). Sec 1031 tax exchange cannot be utilized to buy more expensive house. According to section 1031(a), there is no gain or loss recognized on the exchange of property held for productive use.

2c) From the fact that Jane earned $20,000 last year, it clear that she uses her handcrafting skills to generate an income. Since there is generation of profit from her activities, then it's a clear indication that what she does is not a hobby but a business. Ordinary and necessary expenses can be deducted to conduct the business. According to Sec. 162, using her car to majorly move goods from one shop to another is subject to tax as business expense ((Smith, 2013)

2d) Since John and Jane both generate an income, then it's advantageous to file jointly. The tax rate favors couples who file joint returns. Moreover; filing jointly negates tax credits and deductions. Although it's advantageous for them to file the returns jointly, contributing individually to an individual retirement account alongside joint filing of returns is recommended.

2e) According to section 179, investing in a jewelry-making machine worth $15,000 qualifies for financing since its use is in generating income (Internal Revenue Code:Sec. 121. Exclusion of gain from sale of principal residence). They both should apply for expensing of the jewelry machine and at the same time, Jane should take deduction for $15000 since the jewelry-making machine will not depreciate as capital expenditure (Smith, 2013). This is advantageous since it will lower tax liability on income earned from the business.

3) Analyzing the facts connoted above, it's clear that the advantages of filing returns jointly supersede the disadvantages. Thus, John Smith and Jane Smith should consider filing returns jointly.