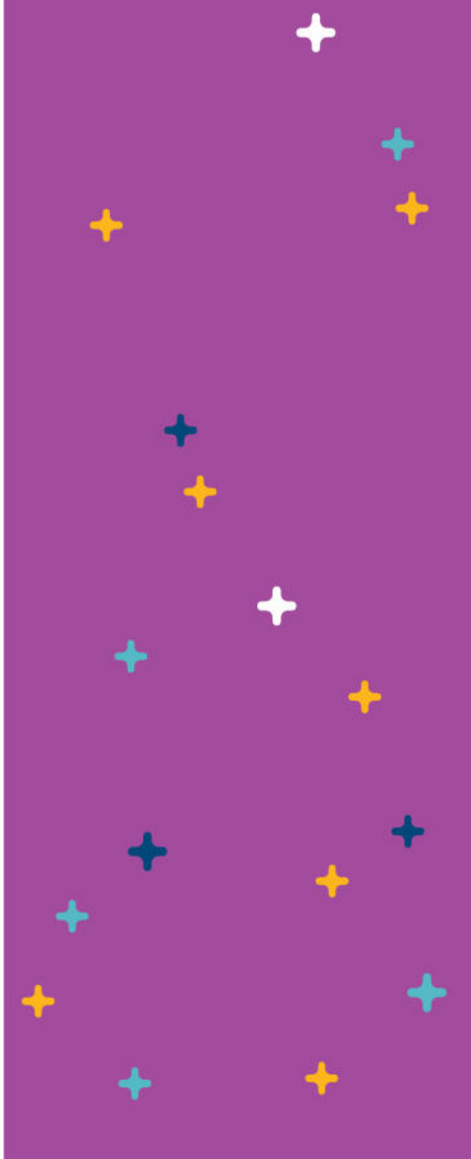
TCP

1

Tax Compliance and Planning for Individuals

Module

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1 Equity Compensation Awards

Employees may receive compensation from their employers in the form of equity awards such as stock options, restricted stock, or stock appreciation rights (SARs). How and when employee equity compensation is taxed to the employee depends on the type of equity award.

Key dates for equity compensation awards include:

- **Grant date:** when the employee receives the award
- **Vesting date:** when the employee has the right to exercise the equity award (restrictions lapse)
- **Exercise date:** when the employee purchases stock using stock options or cashes out SARs
- **Sale date:** when the employee sells restricted stock or stock acquired using stock options
- **Expiration date:** when the rights under the equity award lapse, or expire, unused

1.1 Nonstatutory Stock Options

Corporations may grant their employees the option to purchase stock in the corporation. There are two types of employee stock options: nonstatutory and statutory. A nonstatutory option (also known as a nonqualified option) is taxed when granted if the option has a readily determinable value at the time of the grant. Because nonstatutory options often do not have a determinable value at the time of grant, the option is generally taxed when exercised.

1.1.1 Definition of Readily Determinable Value

If the option is traded on an established market, it will have a readily determinable value. Otherwise, it will only have a readily determinable value if *all* of the following conditions are met:

- The option is transferable.
- The option is exercisable immediately in full when it is granted.
- There are no conditions or restrictions that would have a significant effect on the value.
- The fair value of the option privilege can be readily determined.

1.1.2 Employee Taxation: Readily Determinable Value

- If there is a readily determinable value for the stock option, the employee recognizes ordinary compensation income in that amount in the year granted. If there is a cost to the employee, then the ordinary income is the value of the option minus the cost.
- There is no taxation on the date of exercise.
- The basis of the stock is the exercise price plus any amount previously taxed on the date of grant. Any future sale of the stock could result in a capital gain or loss.
- The holding period of the stock begins on the grant date.
- If the employee allows the options to lapse (not exercised), there is a capital loss based on the value of the options previously taxed.

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1.1.3 Employee Taxation: No Readily Determinable Value

- If no readily determinable value exists, the taxable event is the exercise date, not the grant date.
- On the exercise date, the employee recognizes ordinary compensation income equal to the "bargain element"—the difference between the fair market value of the stock and the stock option price exercised.
- The basis of the stock is the fair market value of the stock when stock option was exercised. Any future sale of the stock could result in a capital gain or loss.
- The holding period of the stock acquired by exercising the option begins with the exercise date.
- If the options lapse, the employee can deduct a capital loss equal to the price, if any, that the employee paid for the options. There are no other income tax consequences.

Example 1 Nonstatutory Stock Option

Facts: On July 1, Year 10, Bob was granted a nonstatutory stock option to purchase 200 shares of his employer's stock for $12 per share, at a time when the stock was selling at $16 per share. This option was selling for $4 per share on an established exchange, so it had a readily determinable value of $4 per share. Bob exercised these options on August 7, Year 11. The stock was selling for $18 per share on the exercise date. On June 1, Year 12, Bob sold all of the shares for $21 per share.

Required:

1. Determine the amount and type of income that Bob must recognize and when the income should be recognized.
2. Assume instead that the stock option did not have a readily determinable value at the date of grant.

Solution:

1. Bob must report ordinary compensation income in the amount of $800 ($4 × 200 shares) on the date of the grant in Year 10 because the option has a readily determinable market value on the date of the grant of $4 per share.

   Bob's adjusted basis in the stock is $3,200 ($2,400 exercise price + $800 recognized ordinary income). The $2,400 exercise price is 200 shares × $12.

   Bob has a long-term capital gain in Year 12 in the amount of $1,000, which is the selling price of $4,200 ($21 × 200 shares) less the adjusted basis of $3,200. The holding period begins from the grant date (July 1, Year 10), which is more than one year, therefore the gain is long-term.

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2. Bob would recognize ordinary compensation income on the exercise date, rather than the grant date, for the amount of the bargain element of $1,200 ($18 FMV of stock when option is exercised – $12 exercise price = $6 × 200 shares = $1,200).

Bob's adjusted basis in the stock acquired is the FMV of the stock, or $3,600 ($18 × 200 shares).

Bob has a short-term capital gain in Year 12 of $600, which is the selling price of $4,200 ($21 × 200 shares) less the adjusted basis of $3,600. The holding period begins from the exercise date (August 7, Year 11), which is less than one year before the sale date of June 1, Year 12, therefore the gain is short-term.

1.2 Statutory Stock Options

There are two types of statutory stock options, incentive stock options (ISO) and stock options granted under employee stock purchase plans (ESPP). Both types of options are eligible to receive favorable tax treatment under the internal revenue code.

1.2.1 Incentive Stock Options

An ISO is a right that's given to an employee to buy stock in the company.

The following are some key points related to an ISO:

- The ISO must be granted under a written plan document, approved by the shareholders, that indicates the total number of shares that may be issued and the employees that are eligible to participate.
- The employee may not own more than 10 percent of the combined voting power of the corporation, parent, or subsidiary as of the date of the grant.
- The employee must remain an employee of the corporation from the date the option is granted until three months (one year if due to permanent and total disability) before the option is exercised.
- The options must be exercisable within 10 years of the grant date.
- The exercise price may not be less than the FMV of the stock at the date of the grant.
- Once exercised, the stock must be held at least two years after the grant date *and* at least one year after the exercise date.
- An employee may exercise up to $100,000 of ISOs in a year. Any amount exercised that exceeds this amount will be treated as a nonstatutory option.

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1.2.2 Employee Stock Purchase Plans

An ESPP is a type of plan that allows employees to purchase company stock at a discounted price. With an ESPP, participating employees contribute to the plan through payroll deductions.

The following are some key points related to an ESPP:

- The plan must be written and approved by the shareholders.
- An ESPP cannot grant options to any employee who has 5 percent or more combined voting power of the corporation, parent, or subsidiary. Generally, the plan must be available to all full-time employees other than highly compensated employees and those with less than two years of employment.
- The option exercise price may not be less than the *lesser* of 85 percent of the FMV of the stock when granted or exercised.
- The option cannot be exercised more than 27 months after the grant date.
- No employee can acquire the right to purchase more than $25,000 of stock per year.
- Once exercised, the stock must be held at least two years after the grant date *and* at least one year after the exercise date.
- The employee must remain an employee of the corporation from the date the option is granted until three months before the option is exercised.



Pass Key

People often confuse the holding period with a vesting period, which is not the same. This is a common exam trap.

- **Vesting Period:** When you earn the right to exercise the stock option.
- **Holding Period:** How long you hold the stock, which determines whether you receive favorable tax treatment.

ISOs and ESPPs have a holding period requirement (two and one period, respectively), but not a vesting requirement.

1.2.3 Similarities Between ISOs and ESPPs

There are five similarities between ISOs and ESPPs to be aware of, which can be remembered with the mnemonic **SWEET**:

- (S) Both are **statutory** (qualified) stock options offered only to employees.
- (W) Both must be **written** and approved by the shareholders.
- (E) Both provide **enhanced tax advantages** compared to nonstatutory (nonqualified) stock options.
- (E) Both require the **employee** to remain an employee from the date the option is granted until three months before the option is exercised.
- (T) Both have the same **timing** requirement for the holding period to receive preferential tax treatment; once exercised, both require that the stock must be held for at least two years after the grant date and one year after the exercise date.

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1.2.4 Differences Between ISOs and ESPPs

The following chart summarizes the six key differences between ISOs and ESPPs:

Feature	ISO (Incentive Stock Option)	ESPP (Employee Stock Purchase Plan)
Purpose	Incentivize/reward select employees	Allow most employees to purchase stock via payroll
Eligibility	Select or discretionary, often executives/key employees	• Broad-based, nondiscriminatory • Must be offered to all employees if ≥2 years employed
Limitations	Must have ≤10% ownership and voting power	Must have <5% voting power
Price limit	No discount. Exercise price ≥ FMV at grant date	15% max discount: Option price must be ≥85% of the lesser of FMV on grant or exercise date
Transaction limit	Must be ≤$100,000 exercisable per year (based on FMV at grant)	Must be ≤$25,000 purchased per year (based on FMV at grant)
Time limit	Must be exercised ≤10 years from the grant date	Must be exercised ≤27 months from the grant date



Pass Key

Two/One: Stock acquired by exercising statutory stock options must be held at least *two* years after the grant date and at least *one* year after the exercise date to receive long-term capital gain treatment.

1.2.5 Taxation of Statutory Stock Options

- Generally, there is no taxation of the option as compensation.
- The basis of the stock acquired is the exercise price plus any amount paid for the option (if any).
- Gain or loss on a subsequent sale of the stock is capital if the stock is held for at least two years after the grant date and at least one year after the exercise date.
- If the two-year/one-year holding period requirements are not satisfied, any gain is ordinary up to the amount that the stock's FMV on the exercise date exceeds the option price. Any excess gain is capital gain. Any loss is a capital loss.
- Generally, if the options lapse, no deduction is available as the option was not taxed in the first place. There may be a loss if any amount was paid for the option itself.
- An employee may exercise up to $100,000 of ISOs in a year. Any amount exercised that exceeds this amount will be treated as a nonstatutory option.

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- For an ESPP, if the option exercise price is less than the FMV of the stock on the grant date, then ordinary income is recognized when the stock is sold. The ordinary income recognized is the lesser of:
  - the difference of the FMV of the stock when sold and the exercise price; or
  - the difference between the exercise price and the FMV of the stock on the grant date.
  - This only applies to ESPPs because, for ISOs, the exercise price may not be less than the FMV of stock on the grant date.
- The excess of the FMV of the stock on the exercise date over the purchase price is a preference item for alternative minimum tax.

Tax Treatment by Employees

Key Dates	*Nonstatutory Stock Options With Readily Determinable Value*	*Nonstatutory Stock Options Without Readily Determinable Value*	*Statutory (Qualified) Stock Options (ISOs and ESPPs)*
Grant date	Ordinary income = FMV of stock options on date of grant	No tax consequences	No tax consequences
Vesting date	Same as grant date	Same as grant date	Same as grant date
Exercise date	• No taxable income • Basis in stock = exercise price + income recognized at grant date	• Bargain element (FMV of stock – exercise price) = ordinary income • Basis in stock = FMV of stock when stock option is exercised	• No taxable income • Basis in stock = exercise price
Holding Period	• Begins on grant date	• Begins on exercise date	• Two years after grant date + one year after exercise date
Date stock is sold	Capital gain (loss); short-term or long-term depending on holding period	Capital gain (loss); short-term or long-term depending on holding period	• Two-year/one-year holding period met: Long-term capital gain (loss) • Two-year/one-year holding period not met: *Gain*: bargain element (FMV of stock when exercised – exercise price) = ordinary income; any excess gain is capital gain *Loss*: capital loss
Date options expire if not exercised	Capital loss = FMV of options previously taxed at date of grant; short-term or long-term depends on holding period	Capital loss = price paid for options (if any); short-term or long-term depends on holding period	Capital loss = price paid for options (if any); short-term or long-term depends on holding period

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Example 2 Incentive Stock Option

Facts: On July 1, Year 10, Mary was granted an Incentive Stock Option (ISO) to purchase 200 shares of her employer's stock for $120 per share. The FMV of the stock on the date of grant was $120. Mary exercised these options on August 7, Year 11. The stock was selling for $150 per share on the exercise date. On November 1, Year 12, Mary sold all of the shares for $200 per share.

Required: Determine the amount and type of income that Mary must recognize and when the income should be recognized.

Solution: Mary does not recognize any ordinary income at the grant date because this qualifies as an ISO.

Mary's adjusted basis in the stock is the exercise price of $24,000 (200 shares × $120).

Mary has a long-term capital gain in Year 12 in the amount of $16,000, which is the selling price of $40,000 (200 shares × $200) less the adjusted basis of $24,000. The long-term holding period requirement of more than one year has been met.

Mary also has an AMT preference item in Year 11 of $6,000. The FMV of stock on the exercise date was $150, and the purchase price was $120, so the excess of the FMV over the purchase price is $30. $30 excess × 200 shares = $6,000.

1.3 Restricted Stock

With a restricted stock award, an employee receives actual shares of the employer's stock, rather than an option to purchase the employer's stock. For restricted stock shares, the employee is restricted from selling the stock until the vesting date when the restrictions lapse.

1.3.1 Employee Taxation on Restricted Stock Awards

The employee recognizes ordinary compensation income for the FMV of the stock on the day it vests and the restrictions lapse. The employee's basis in the stock is the FMV on the vesting date, and the employee's holding period for the stock begins on the vesting date.

An employee may elect to recognize ordinary compensation income for the FMV of the stock on the grant date. The election must be made within 30 days of the date the restricted stock award is granted and is irrevocable.

1.3.2 Restricted Stock Units (RSUs)

RSUs are not actual shares of employer stock; they are a promise to give an employee a specified number of unrestricted shares of employer stock on the vesting date. As with restricted stock awards, employees recognize ordinary compensation income for the FMV of the stock on the vesting date. However, there is no election allowed to recognize income on the grant date rather than the vesting date like there is for restricted stock awards.

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Example 3 Restricted Stock Award

Facts: On July 1, Year 10, Agnes was granted 200 shares of restricted stock. The FMV of the stock on the date of grant was $100/share. The stock vested, and the restrictions lapsed, on August 7, Year 11, when the stock was selling for $110/share. Agnes sold the stock on November 1, Year 12, for $125/share.

Required: What is the amount and character of Agnes' taxable income in Years 10, 11, and 12 related to the restricted stock award?

Solution:

Year 10: $0 taxable income

Agnes does not recognize any income when the restricted stock is granted.

Year 11: $22,000 ordinary compensation income

The employee recognizes the FMV of the stock on the vesting date as ordinary compensation income. $110 × 200 shares = $22,000.

Year 12: $3,000 long-term capital gain

The employee's basis in the 200 shares of stock is the FMV on the vesting date, which is $22,000. The selling price of the stock is $25,000 ($125 × 200 shares), so Agnes has a $3,000 capital gain ($25,000 selling price – $22,000 basis).

The holding period for the stock begins on the August 7, Year 11, vesting date. Since Agnes sold the stock on November 1, Year 12, the holding period was more than one year, which is long-term.

1.4 Stock Appreciation Rights

With stock appreciation rights (SARs), employees do not receive actual shares of employer stock. When an employee exercises a SAR, the employee receives a payment equal to the difference between the FMV of the stock on the exercise date and the FMV on the date the SAR was granted by the employer. The employee recognizes ordinary compensation income for the amount of the cash payment when the SAR is exercised.

2 Imputed Interest on Below-Market-Rate Loans

If a taxpayer makes a below-market-rate loan, the taxpayer must report any foregone interest from that loan as interest income. If a taxpayer receives a below-market loan, the taxpayer may be able to deduct the foregone interest, unless it is personal interest.

2.1 Foregone Interest

Foregone interest on a loan is the excess of:

- interest based on the applicable federal rate (AFR) published regularly by the IRS; over
- any interest actually payable on the loan.

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2.2 Loans Subject to Imputed Interest Rules

- **Gift Loans:** between individuals (friends and family members)
- **Compensation-Related Loans:** between employer and employee, or independent contractor and person for whom the contractor provides services
- **Corporation-Shareholder Loans:** between a corporation and a shareholder of the corporation
- **Tax-Avoidance Loans:** a below-market loan where the avoidance of federal tax is a main purpose of the interest arrangement
- **Loans to Qualified Continuing Care Facilities:** any loan to any qualified continuing care facility, pursuant to a continuing care contract where lender (or lender's spouse) is age 65 or older at the end of the year

Example 4 Imputed Interest on a Below-Market-Rate Loan

Facts: Pat is in a financial bind and has asked Robert for a $20,000 loan. Because of the financial difficulties Pat is experiencing, Robert has made the loan to Pat at an annual interest rate of 1 percent. The current AFR is 3 percent.

Required: Determine the imputed interest income that must be reported by Robert for the below-market-rate loan to Pat.

Solution: Imputed interest is $400, calculated as follows:

- Minimum interest required by the AFR: $600 ($20,000 × 3% = $600)
- Interest payable under the loan (and reported as interest income by Robert): $200 ($20,000 × 1% = $200)
- $600 minimum interest required by the AFR – $200 interest payable under the loan = $400

2.3 De Minimis Exceptions for Loans of $10,000 or Less

The imputed interest rules for below-market loans do not apply to any day on which the total outstanding amount of loans between the borrower and lender is $10,000 or less for the following types of loans:

- **Gift Loans between individuals:** as long as the funds are not used to purchase income producing assets.
- **Compensation-Related and Corporate-Shareholder Loans:** if avoidance of federal tax is not a principal purpose of the interest arrangement.

2.4 Exception for Loans Without Significant Tax Effect

In addition to the de minimis exceptions, there are general exceptions for below-market loans if their interest arrangements do not have a significant effect on the federal tax liability of the borrower or lender. These include:

- Government-subsidized loans, such as student loans;
- Loans provided by a lender to the general public that are consistent with the lender's normal business practices, such as no-interest financing on an automobile or a zero-interest period on a credit card;

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- Loans to assist an employee with work relocation;
- Certain loans to/from a foreign person; and
- Gift loans to a Section 501(c)(3) charitable organization, if total outstanding loans between the borrower and lender is no more than $250,000 at all times during the year.

2.5 Gift Loans of $100,000 or Less

For gift loans between individuals, if the outstanding loans between the lender and borrower total $100,000 or less, the foregone interest included in the lender's income and deducted by the borrower is limited to the amount of the borrower's net investment income for the year.

- If the borrower's net investment income is $1,000 or less, the foregone interest is treated as zero.
- The foregone interest limitation does not apply if avoidance of federal tax is one of the main purposes of the interest arrangement.

3 Compensation Earned While Employed Outside the U.S.

A taxpayer may exclude from U.S. gross income up to $132,900 (2026) of income earned while residing in a foreign country. This exclusion from gross income is significant. For an individual filing single:

- At the lowest 24 percent marginal rate at this income level, the income tax savings is $31,896 (2026).
- At the highest 37 percent marginal rate, the income tax savings is $49,173 (2026).

3.1 Foreign-Earned Income

Foreign-earned income includes the following income items:

- Bonuses
- Commissions
- Professional fees
- Salaries and wages
- Tips

3.2 Qualifications for the Foreign-Earned Income Exclusion

In order to qualify for the exclusion, a taxpayer must satisfy one of the following two tests:

1. **Bona Fide Residence Test:** The taxpayer must have been a bona fide resident of a foreign country, or countries, for an uninterrupted period that includes the entire taxable year.
2. **Physical Presence Test:** The physical presence test requires that the taxpayer be physically present in a foreign country, or countries, for 330 full days during any 12-consecutive-month period, although the 330 days do not need to be consecutive.

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Example 5 Compensation Earned While Employed Outside the U.S.

Facts: Thomas Peters, a single U.S. citizen, has found a job working as a tour guide and interpreter in Israel and moved there 12 months ago. Since that time, he has only been home to Idaho once to visit his parents for two weeks.

Required: Does the income earned by Thomas qualify for the foreign-earned income exclusion?

Solution: Yes, the income Thomas earns while working in Israel qualifies because he was physically present in a foreign country for 351 days (365 – 14).

4 Timing of Income and Expenses

Understanding the implications of the timing of income and deductions is an effective tool for maximizing the after-tax wealth of a taxpayer. Using the time value of money principles, a taxpayer can evaluate the effect of the timing of a tax decision. The two basic tax strategies, assuming that the taxpayer's tax rate remains constant, are to:

1. Defer taxable income
2. Accelerate tax deductions

However, important tax factors may change from year to year in a dynamic tax environment. These changes may be a result of a change in tax law or a change in the taxpayer's personal situation, such as retirement or opening a new business. Therefore, many other factors must be considered for tax planning. These include:

- Type of income
- Changing tax rates
- Type of entity
- Taxpayer's filing status

Example 6 Timing of Income (With Constant Tax Rates)

Facts: Jill Jones owns a small retail business. Jill is a cash-basis, calendar-year taxpayer. She reports her income and expenses related to the business on Schedule C. Jill has the opportunity to make an unusually large sale in the amount of $100,000 and is trying to determine the best tax strategy regarding the timing of the sale. She can finalize the sale and receive payment on either December 31 of the current year or January 1 of next year. Jill's marginal tax rate is 32 percent in both tax years. (For all examples that follow, assume an after-tax rate of return on investments of 10 percent for present value analysis. The present value factor for one year at 10 percent is 0.909.)

Required: Advise Jill on whether it is optimal for the sale to be made in the current year on December 31 or next year on January 1.

Solution: If Jill finalizes the sale and receives payment on December 31 of this year, she will have to report the $100,000 of income on this year's tax return. However, if she waits to finalize the sale on January 1, then she will have income one year later on next year's tax return.

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Compare the after-tax effect of Jill's $100,000 sale:

	Option A: $100,000 Income This Year	Option B: $100,000 Income Next Year
Income	$100,000	$100,000
Marginal tax rate	× 32%	× 32%
Tax on income	32,000	32,000
Discount factor	× 1	× 0.909
Present value of tax	$ 32,000	$ 29,088
Income after tax:		
Before-tax income	$100,000	$100,000
Less: Present value of tax	(32,000)	(29,088)
Income after tax	$ 68,000	$ 70,912

Option B to defer the $100,000 income to next year results in $2,912 in additional income after tax, considering the time value of money since the present value of tax paid one year later is lower than if the tax is paid in the current year.

Example 7 Timing of Income (With Increasing Tax Rates)

Facts: Using the example above, assume that Jill's marginal tax rate is 32 percent this year but will increase to 35 percent next year.

Required: Advise Jill on whether it is optimal for the sale to be made in the current year on December 31 or next year on January 1.

Solution:

	Option A: $100,000 Income This Year	Option B: $100,000 Income Next Year
Income	$100,000	$100,000
Marginal tax rate	× 32%	× 35%
Tax on income	32,000	35,000
Discount factor	× 1	× 0.909
Present value of tax savings	$ 32,000	$ 31,815
Income after tax:		
Before-tax income	$100,000	$100,000
Less: Present value of tax	(32,000)	(31,815)
Income after tax	$ 68,000	$ 68,185

Although Option B is still more attractive, the increase in taxable income is only $185. A taxpayer must evaluate the specific facts and circumstances in his or her tax situation to effectively understand the timing effects of taxable income.

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Example 8 Timing of Deductions (With Constant Tax Rates)

Facts: Jill is planning to purchase new equipment for her retail business that costs $20,000. Jill is considering whether to purchase the equipment this year and therefore deduct the cost of the equipment on this year's tax return or purchase the equipment next year and deduct the cost of the equipment on next year's tax return. Jill's marginal tax rate is 32 percent.

Required: Determine which year Jill should purchase the equipment to provide the lowest after-tax cost.

Solution:

	Option A: Purchase $20,000 Equipment This Year	Option B: Purchase $20,000 Equipment Next Year
Tax deduction	$20,000	$20,000
Marginal tax rate	× 32%	× 32%
Tax savings	6,400	6,400
Discount factor	× 1	× 0.909
Present value of tax savings	$6,400	$5,818
After-tax cost of equipment:		
Before-tax cost	$20,000	$20,000
Less: Present value of tax	(6,400)	(5,818)
After-tax cost	$13,600	$14,182

Option A offers Jill the lowest after-tax cost of the equipment.

Example 9 Timing of Deductions (With Increasing Tax Rates)

Facts: Use the same facts as above, but now assume that Jill expects that her business income will rise with the use of the new equipment. Therefore, her marginal tax rate will increase from 32 percent in the current year to 35 percent next year.

Required: Determine which year Jill should purchase the equipment to provide the lowest after-tax cost.

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Solution:

	Option A: Purchase $20,000 Equipment This Year	Option B: Purchase $20,000 Equipment Next Year
Tax deduction	$20,000	$20,000
Marginal tax rate	× 32%	× 35%
Tax savings	6,400	7,000
Discount factor	× 1	× .909
Present value of tax savings	$ 6,400	$ 6,363
After-tax cost of equipment:		
Before-tax cost	$20,000	$20,000
Less: present value of tax	(6,400)	(6,363)
After-tax cost	$13,600	$13,637

With an increased tax rate next year, Option A is still more attractive, but only slightly so ($37).

Many factors must be considered in determining the timing of income and deductions for a taxpayer. In a changing tax environment, the facts and circumstances unique to the taxpayer must be evaluated. The examples above illustrate the effect of properly timing income and deductions to increase the after-tax wealth of a taxpayer.

5 Alternative Minimum Taxable Income

The alternative minimum tax (AMT) system was implemented to ensure that individual taxpayers, particularly those with high income who use certain tax breaks under the tax law in order to significantly reduce their tax liability, pay at least some minimum amount of income tax.

Under the AMT system, taxpayers perform an alternative calculation of tax liability based on AMT income and AMT rates, and pay the AMT amount if it is more than the taxpayer's regular tax amount.

Alternative minimum taxable income (AMTI) more closely represents a taxpayer's economic income than does regular taxable income. It is calculated by increasing or decreasing regular taxable income for specific adjustment and tax preference items.

Regular taxable income
± Adjustments
+ Tax preferences
Alternative minimum taxable income

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5.1 Adjustments (Adds or Subtracts)

Adjustments are defined in the tax code as specific items that may increase or decrease AMT, because the treatment of the item for AMT purposes is different from that for regular tax purposes. Examples of common adjustments are listed below. Items 1–5 are "timing differences" that may increase or decrease AMTI. Items 6–7 are items that may be included in deductions for regular tax purposes, but not for AMT purposes, and will only increase AMTI.

1. **P**assive activity losses are added back, or recalculated.
2. **A**ccelerated depreciation:
   - On real property, this is the difference between regular tax depreciation and straight-line using a 40-year life for property placed in service after 1986.
   - On personal property, this is the difference between regular tax depreciation and 150 percent declining balance (with switch to straight-line). (If a taxpayer elects 150 percent declining-balance depreciation for regular tax purposes, there will be no AMT depreciation adjustment of 200 percent declining-balance eligible property.)
   - No adjustment is required for property expensed under Section 179.
3. **N**et operating loss of the individual taxpayer must be recomputed.
4. **I**nstallment method may not be used by a dealer for property sales.
5. **C**ontracts (long term): The difference between the percentage-of-completion method and completed-contract method or any other method of accounting is an adjustment.
6. **T**axes: itemized deduction, net of taxable tax refunds (if refunds meet the tax benefit rule) are added back.
7. **S**tandard deduction, if claimed, is added back.

5.2 Other AMT Adjustments

- Incentive stock options exercised
- Recalculate gain or loss on sale of depreciable assets
- Pollution control facilities amortization deductions
- Mining exploration and development costs
- Circulation expenses
- Research and experimental expenditures
- (Passive) tax shelter farm activities

5.3 Tax Preference Items (Always "Adds" to Regular Taxable Income)

By definition in the tax code, tax preference items are always add-backs. These items will result in more income or fewer deductions being recognized for AMT versus regular tax. Examples of common tax preference items include:

- **P**rivate activity bond tax-exempt interest income (on certain bonds)
- "**P**ercentage depletion" deduction (excess over adjusted basis of property)
- **P**re-1987 accelerated depreciation on real property and leased personal property (excess over straight-line for property placed in service before 1987)

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Illustration 1 Adjustment Related to Contracts

Mary has a long-term construction contract in Year 1 and uses the completed-contract method for regular tax purposes. She reports income for regular tax of $20,000 in Year 4, the year the contract is completed. AMT requires the use of the percentage-of-completion method. Under this method, income would be reported as follows: $2,000 in Year 1; $5,000 in Year 2; $5,000 in Year 3; and $8,000 in Year 4.

Mary has an AMT adjustment in the amounts of $2,000 in Year 1, and $5,000 each in Years 2 and 3. These adjustments will increase AMTI because more income is being recognized for AMT purposes than for regular tax purposes. In Year 4, Mary has an adjustment of $12,000 that will decrease AMTI in Year 4. This is because regular tax recognized the entire $20,000 income in Year 4, but AMT only recognized $8,000 under percentage of completion. Because AMT recognized less income in the final year of the contract, the adjustment is a decrease to AMTI.

Illustration 2 AMT Adjustments

In Year 2, Janet has various itemized deductions. They include interest on acquisition indebtedness on her home of $11,200; state income tax deductions of $9,200; and charitable contributions of $3,000. Her total adjustments for AMT purposes are $9,200 (state income tax deductions).

These adjustments increase AMTI because they are the disallowance of deductions that are allowed for regular tax purposes. Note that the charitable contributions and acquisition indebtedness are not adjustments for purposes of AMT.

Illustration 3 Tax-Exempt Interest Preference Item

In Year 2, Janet has total tax-exempt interest of $15,000. Of this tax-exempt interest, $1,300 is deemed to be from private-activity bonds. Her total preference add-back for AMT purposes is $1,300.

The result here is that $15,000 tax-exempt interest is exempt from regular tax, but $1,300 of that amount must be recognized for AMT. Therefore, only $13,700 is exempt for AMT purposes ($15,000 − $1,300).

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Illustration 4 AMTI Calculation

Continuing with the illustrations for Janet from above: Assume that In Year 2, Janet has regular taxable income of $60,000. From the above illustrations, her adjustments are $9,200 and her preference items are $1,300. These are both added back to taxable income to arrive at alternative minimum taxable income (AMTI) of $70,500.

Regular taxable income	$60,000
AMT adjustments	9,200
AMT preference items	1,300
AMTI	$70,500

As indicated in the previous illustrations, these items will both increase AMTI because they are eliminating deductions from the regular taxable income and adding income to the regular taxable income.

6 Kiddie Tax

The net unearned income of a dependent child under 18 years of age (or a child age 18 to under 24 who does not provide over half of his/her own support and is a full-time student) is taxed at the parent's rate. Net unearned income is calculated by taking the child's total unearned income (from dividends, interest, rents, royalties, etc.) and subtracting $2,700 (2026): the child's minimum allowable 2026 standard deduction of $1,350 plus an additional $1,350 that is taxed at the child's regular income tax rate. If the child also has earned income of more than $1,350, the standard deduction is the lesser of earned income plus $450 (2026), or the 2026 single standard deduction amount of $16,100. The amount of unearned income that is taxed at the parent's rate is still unearned income in excess of $2,700 (2026), even if the child is entitled to a larger standard deduction.

Parents may elect to include on their own return the unearned income of the applicable child provided that the income is between $1,350 and $13,500 (2026) and consists solely of interest, dividends, and capital gains distributions.

2026 Child's Unearned Income	Tax Rate
$0–$1,350	0%
$1,351–$2,700	Child's rate
Over $2,700	Parent's rate

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Example 10 Kiddie Tax: Unearned Income Only

Facts: Max is 15 years old and lives with his parents. His only taxable income for the current year is corporate bond interest income of $5,000. Max is in the 10 percent tax bracket and his parents are in the 22 percent tax bracket.

Required: Calculate Max's federal income tax liability for the current year.

Solution: Max's federal income tax liability for the current year is $641.

Adjusted gross income	$5,000
Standard deduction	(1,350)
Taxable income	$3,650

Income taxed at Max's rate	$1,350 × 10% =	$135
Income taxed at parents' rate	$2,300 × 22% =	$506
Total income tax liability		$641

Example 11 Kiddie Tax: Earned Income and Unearned Income

Facts: Maya is 17 years old and lives with her parents. Maya has earned income of $10,000 and unearned income of $5,000 for the current year. Maya's marginal tax rate is 10 percent and her parents' marginal tax rate is 24 percent.

Required: Calculate Maya's federal income tax liability for the current year.

Solution: Maya's federal income tax liability for the current year is $777.

Maya's earned income of $10,000 + $450 is $10,450, which is less than the 2026 single standard deduction of $16,100, so her standard deduction is limited to $10,450.

Maya's unearned income in excess of $2,700 is taxed at her parents' 24 percent marginal tax rate. Her remaining unearned income and her earned income, reduced by her standard deduction, is taxed at Maya's 10 percent marginal tax rate.

Total gross earned and unearned income	$15,000
Standard deduction	(10,450)
Unearned income taxed at parent's rate ($5,000 – $2,700)	(2,300)
	$ 2,250

Earned income taxed at Maya's marginal tax rate	$2,250 × 10% =	$225
Unearned income taxed at parents' marginal tax rate	$2,300 × 24% =	$552
Total income tax liability		$777

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7 Flexible Spending Accounts and Health Savings Accounts

7.1 Flexible Spending Accounts (FSAs)

A flexible spending account, or flexible spending arrangement (FSA), allows an employee to receive a pretax reimbursement for qualified medical expenses and/or qualified dependent care expenses.

7.1.1 Funding

FSAs are typically funded through a voluntary salary reduction agreement with an employer. If additional requirements are met, an employer may contribute to the plan on behalf of the employee as well.

- Contributions are excluded from your gross income.
- No employment or federal income taxes are deducted from the contributions.
- Reimbursements may be tax free if used for qualified expenses.

The maximum annual contributions for FSAs are:

- $5,000 for dependent care FSAs; and
- $3,400 (2026) for health care FSAs.

7.1.2 Forfeitures

Generally, an employee must use the money in an FSA within the plan year. If money is left in an employee's health care FSA account at the end of the plan year, an employer may offer one of two options:

- 2½ month grace period to spend the funds for qualified expenses; or
- Carry over up to $680 (2026) to use in the following year.

Dependent care FSA plans can provide for a 2½ month grace period, but not a rollover to the following year.

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7.2 Health Savings Accounts (HSAs)

A health savings account (HSA) is a type of tax-deferred savings account, very much like an individual retirement account (IRA), that allows a taxpayer to set aside money on a pre-tax basis to pay for qualified medical expenses. Unlike an FSA, HSA funds that are not spent continue to accumulate. The maximum pretax contributions to an HSA for 2026 are:

- Individual $4,400
- Family $8,750
- Increased by $1,000 for taxpayers age 55 or older

7.2.1 High-Deductible Plan

Taxpayers may only contribute to an HSA if they are insured under a high-deductible health plan (HDHP). The minimum deductible for an HDHP is $1,700 for self-only coverage and $3,400 for family coverage (2026). Additionally, there is an annual limit on out-of-pocket expenses paid under the plan. Out-of-pocket expenses include co-payments, deductibles, and other amounts (other than premiums) that must be paid for by the insured. The 2026 limits are:

- $8,500 for self-only coverage
- $17,000 for family coverage

7.2.2 Withdrawals

Amounts withdrawn from an HSA to pay for qualified medical expenses of an account beneficiary are not includable in the beneficiary's gross income. Prior to age 65, withdrawals from an HSA that are not used to pay qualified medical expenses are includable in gross income and are subject to an additional 20 percent tax in addition to income tax.

Once the taxpayer reaches age 65, withdrawals that are not used to pay qualified medical expenses are still included in the taxpayer's gross income, but the 20 percent tax no longer applies. Withdrawals used to pay for qualified medical expenses; Medicare Parts A, B, and D premiums; and long-term care insurance premiums continue to be tax-free.

If a taxpayer has Medicare premiums automatically deducted from their Social Security retirement benefits, the taxpayer can reimburse themselves by withdrawing the equivalent amount from their HSA.

Illustration 5 FSA/HSA

Pat and Roger Martin, a married couple, are ages 65 and 66 respectively. They are very healthy and their only health care expenses are:

- Medicare Part B and Part D premiums: $4,000
- Qualified long-term care insurance premiums: $5,000

Pat and Roger take the standard deduction because it is more than the total of their allowable itemized deductions. Their marginal tax rate is 22 percent. They are looking for a way to increase their spendable income and minimize their income taxes. They each have an HSA.

Solution: Pat and Roger should pay their annual health care expenses with withdrawals from their HSAs. This strategy will allow the distributions ($9,000) from the HSAs to be received tax free. This tax-free distribution for qualified medical expenses will yield the Martin family an additional $1,980 ($9,000 × 0.22) per year of spendable income.

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8 Itemized Deductions or Standard Deduction

8.1 Standard Deduction

Taxpayers who do not have enough qualified expenses to itemize their deductions will take a standard deduction. The standard deduction amounts for the current year are:

2026	
Single	$16,100
Head of household	$24,150
Married filing jointly or surviving spouse	$32,200
Married filing separately*	$16,100
*Available only if both taxpayer and spouse do not itemize.	

8.1.1 Additional Standard Deduction for Age 65 or Older and/or Blindness

The standard deduction for a taxpayer who is age 65 or over or blind is increased by an additional amount.

2026		
	Unmarried	*Married*
One Qualified Taxpayer		
65 or blind Both 65 and blind	$2,050 $4,100	$1,650 $3,300
Two Qualified Taxpayers		
Each 65 *or* blind Both 65 *and* blind		$3,300 $6,600

8.1.2 Charitable Contributions Deduction if Standard Deduction Taken

Individual taxpayers who do not itemize deductions are allowed to take a deduction of up to $1,000 ($2,000 MFJ) for cash contributions to public charities.

8.2 Itemized Deductions

A taxpayer will choose to itemize deductions when the total of their allowable deductions is higher than the standard deduction. Itemized deductions include the following:

- Medical expenses (in excess of 7.5 percent of AGI floor)
- Taxes—state/local (limited to $40,400 in 2026)
- Interest expense (home mortgage and investment)
- Charitable contributions (in excess of 0.5 percent of AGI floor)
- Casualty/theft loss attributable to federal or state-declared disaster (in excess of $100 per casualty and aggregate of the losses exceeds 10 percent of AGI)

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Indications that a taxpayer may benefit by itemizing deductions would be, but are not limited to, any of the following:

- Large contributions to qualified charities
- Large uninsured medical and dental expenses
- Mortgage interest and property taxes on a home
- Significant uninsured casualty or theft losses

8.3 Bunching Itemized Deductions

One tax planning strategy that individual taxpayers can use is bunching itemized deductions into a single year. This can be advantageous for taxpayers with itemized deductions that are close to, but not quite as much as, the standard deduction amount. Without bunching, the taxpayer would use the standard deduction amount. By bunching itemized deductions such as charitable contributions or medical expenses into a single year, the taxpayer can take the higher itemized deduction in the bunching year, then take the standard deduction the next year when their itemized deductions are much lower.

This strategy could also be used with the payment of property taxes. Depending on the amount of the taxpayer's total state and local property taxes, bunching may also be a way to avoid the $40,400 (2026) limitation in one of the two years.

Example 12 Bunching Itemized Deductions

Facts: Elizabeth Roberts is a 64-year-old single taxpayer. She is not claimed as a dependent on another taxpayer's return. She has the following potential itemized deductions this year and expects these to be approximately the same next year:

State and local taxes	$ 7,500
Interest expense (on home mortgage)	5,000
Charitable contribution (church)	2,500
Total	$15,000

Elizabeth is trying to decide when she should make the charitable contributions to her church for this year and next year (for purposes of this example, ignore the AGI limitations for itemizing charitable contributions). (Although the standard deduction amounts are indexed for inflation annually, assume for the purposes of this example that the amounts are the same for Year 1 and Year 2.)

Required: Determine when Elizabeth should make the two $2,500 charitable contributions to her church to achieve the greatest tax benefits:

- *Option 1:* $2,500 in Year 1 and $2,500 in Year 2
- *Option 2:* $5,000 in Year 1
- *Option 3:* $5,000 in Year 2

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Solution: Elizabeth would be better off with option 2, making both charitable contributions, all $5,000, in Year 1.

The standard deduction amount for single taxpayers is $16,100 (2026). Because Elizabeth turns age 65 next year, she will receive an additional standard deduction in Year 2 of $2,050 (2026), so her total Year 2 standard deduction amount is $18,150 ($16,100 + $2,050). Additionally, if Elizabeth claims the standard deduction, she is allowed to take a deduction of up to $1,000 for charitable contributions when calculating her taxable income.

If Elizabeth contributes $2,500 to her church in Year 1 and $2,500 in Year 2 (option 1), her total qualified deductions of $15,000 ($7,500 state and local taxes + $5,000 mortgage interest + $2,500 charitable contribution) are less than her standard deduction amount each year, so she will just get the standard deduction in both years.

If Elizabeth contributes all $5,000 to her church in Year 2 (option 3), her total qualified deductions in Year 1 are $12,500 ($7,500 state and local taxes + $5,000 mortgage interest) and $17,500 ($7,500 state and local taxes + $5,000 mortgage interest + $5,000 charitable contribution) in Year 2. Both of these amounts are less than her standard deduction amount for the year ($16,100 in Year 1, $18,150 in Year 2) plus the $1,000 charitable deduction in each year for taxpayers who claim the standard deduction, so again she will just get the standard deduction both years.

If Elizabeth contributes all $5,000 to her church in Year 1 (option 2), she will be able to itemize deductions in Year 1 and take the standard deduction in Year 2 when she gets the additional amount for age 65. Her total Year 1 qualified deductions are $17,500 ($7,500 state and local taxes + $5,000 mortgage interest + $5,000 charitable contribution), which is $400 more than her Year 1 standard deduction of $16,100 plus the $1,000 deduction for charitable contributions when a taxpayer takes the standard deduction. Her total Year 2 qualified deductions are $12,500 ($7,500 state and local taxes + $5,000 mortgage interest), which is much lower than her Year 2 standard deduction of $18,150 plus the $1,000 deduction for charitable contributions. With the additional standard deduction for age 65, she is better off with the standard deduction next year anyway. By paying both charitable contributions in Year 1, Elizabeth is able to itemize deductions in one year and reduce her taxable income by an additional $400.

9 Estimated Tax Payments and Underpayment Penalties

9.1 General

Taxpayers who expect to owe tax of $1,000 or more must pay estimated taxes in a timely manner as income is earned or received throughout the year. There is an exception for taxpayers who had no tax liability for the full 12-month preceding tax year. In addition to income tax, estimated tax is required for other taxes such as self-employment tax. The IRS imposes penalties for failure to pay sufficient estimated tax, as well as failure to make tax payments when due throughout the course of the year. These penalties will be assessed even if the taxpayer is due a refund.

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9.2 Tax Payments

Estimated tax payments are typically based on the prior year's tax return, or anticipated income for the current year. Estimated taxes are typically made in quarterly payments. For the purpose of estimated tax payments, the year is divided into four periods. Each quarterly estimate has a specific payment due date. If sufficient tax is not paid by the due date of each of the payment periods, the taxpayer may be assessed a penalty. Estimated tax payments are due as follows:

- January 1 to March 31: due April 15
- April 1 to May 31: due June 15
- June 1 to August 31: due September 15
- September 1 to December 31: due January 15 of the following year

9.3 Penalty for Failure to Make Sufficient Estimated Tax Payments

If sufficient tax is not paid throughout the year through withholding and/or timely estimated tax payments, the taxpayer may be assessed a penalty for underpayment of the estimated tax. The amount of the penalty for underpayment of estimated taxes is based on:

- The amount of the underpayment
- The period when the underpayment was due and underpaid
- The interest rate for underpayments published by the IRS

The penalty may be avoided if:

- The taxpayer's filed tax return shows less than $1,000 in tax owed; or
- The taxpayer paid the lesser of:
  - 90 percent of the current year's tax; or
  - 100 percent of the prior year's tax (110 percent if prior year's AGI > $150,000).

The Internal Revenue Service (IRS) may waive the penalty if the failure to pay was the result of casualty, disaster, illness, or death of the taxpayer.

9.4 Failure-to-Pay Penalty

The penalty for failure to pay tax owed is one-half of 1 percent per month (or partial month) up to a maximum of 25 percent of the unpaid tax. The penalty is not assessed if at least 90 percent of the tax due is paid by the unextended due date of the tax return; and the balance is paid by the extended due date of the tax return.

Example 13 Underpayment Penalties

Facts: Sarah Wilson owns an apple orchard. She filed timely quarterly estimated tax payments of $23,500. When she filed her current year tax return, Sarah's tax liability was $25,000, and her tax due was $1,500.

Required: Will Sarah Wilson be subject to the failure to make sufficient estimated tax payments or failure-to-pay penalties?

Solution: No, Sarah is not subject to any underpayment penalties because she prepaid over 90 percent of her current year tax liability ($25,000 × 90% = $22,500).

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10 Year-End Tax Planning

Both changes in the tax law and changes in a taxpayer's personal or financial situation can provide opportunities for year-end tax planning. Changes in a taxpayer's personal situation include changes in:

- Filing status
- Dependents
- Home ownership
- Employment
- Higher education

Often tax planning is about the timing of income or expenses to reduce taxable income or maximize tax credits. The following is a comprehensive example that includes several of the year-end tax planning opportunities discussed in this unit.

Example 14 Year-End Tax Planning

Facts: Rob Johnson, age 48, is single and a key employee of a publicly traded company. His salary for the current year is $180,000 and he has total itemized deductions of $14,500. Rob's withholdings for the current year are $31,000. The amount of tax reported on his Form 1040 in the previous year was $31,516.

Rob wants to sell some employer stock that he obtained three years ago by exercising an incentive stock option (ISO) before the end of the current year. The anticipated taxable gain on the sale of the stock is $20,000. Rob is concerned about having to pay estimated tax payments or a penalty for underpayment of tax due to the taxable gain, so he is exploring other actions to take to offset any additional taxes.

First, Rob is considering giving $5,000 of the sales proceeds to a local charity. He is also considering enrolling in a qualified health savings account (HSA) high-deductible health plan with his employer and contributing the maximum allowable amount for the current year.

Required:

1. Provide Rob with recommendations regarding the proposed sale of stock obtained with ISOs, the HSA contribution, and the charitable gift. For purposes of this example, ignore any AGI limitations for itemizing charitable contributions.
2. Calculate Rob's taxable income and tax liability before and after the proposedcharitable gift and HSA contribution.
3. Determine whether Rob must pay estimated tax payments or is subject to penalties for underpayment of tax.

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Solution:

1. Recommended actions:

- Sell the employer stock obtained through the ISO. This strategy would allow Rob to secure long-term capital gain tax treatment on an employer compensation arrangement (Two-year/one-year holding period requirement for qualified stock options met).
- Enroll in the high-deductible health plan with his employer in order to contribute to the HSA. This strategy would allow Rob to make contributions of up to $4,400 (2026 maximum HSA contribution for individuals with self-only coverage) to a health plan to help cover health care costs. The pretax contributions will decrease his taxable earnings and AGI, reducing his current tax liability.
- Choose to itemize deductions to obtain the benefit of the charitable deduction. This strategy would allow Rob to reduce his current tax liability by itemizing deductions in the amount of $19,500 ($14,500 original deductions plus $5,000 gift to charity) rather than using the single standard deduction of $16,100 (2026)

2. Current year tax return before and after charitable gift and HSA contribution:

	Before	**After**
Income	$180,000	$180,000
Contribution to HSA		(4,400)
AGI	$180,000	$175,600
Standard deduction	(16,100)	
Itemized deductions		(19,500)
Ordinary taxable income (taxed at ordinary tax rates)	$163,900	$156,100
LTCG from sale of ISO stock (taxed at preferential tax rates)	$ 20,000	$ 20,000
Ordinary income tax*	$ 31,934	$ 30,062
Preferential income tax on LTCG ($20,000 × 15%)	3,000	3,000
Total Income tax	$ 34,934	$ 33,062
Tax savings ($34,934 – $33,062)		$ 1,872

Implementing these planning recommendations resulted in Rob utilizing a $5,000 deduction from making a charitable gift, increasing his tax-deductible savings (from his HSA contribution) by $4,400 and saving $1,872 in taxes overall.

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3. Estimated tax payments and penalties for underpayment of tax:

To determine whether Rob will have to pay estimated tax payments or penalties for underpayment of tax by implementing these tax planning strategies, we will need to compare 110 percent of the prior year tax paid or 90 percent of the current year tax due against Rob's current year withholdings.

- Prior year tax paid of $31,516 × 110% = $34,668
- Current year tax due $33,062 × 90% = $29,756
- Lesser of 110% of prior year tax ($34,668) and 90% of current year tax due ($29,756) = $29,756
- Current year withholdings = $31,000

Because Rob's current year withholdings are greater than 90 percent of the current year tax, Rob will not need to pay estimated tax payments or be subject to an underpayment penalty if the recommended actions are implemented.

If Rob does *not* implement the recommended tax planning strategies, he would need to make an estimated tax payment or be subject to underpayment penalties:

- Prior year tax paid of $31,516 × 110% = $34,668
- Current year tax due $34,934 × 90% = $31,441
- Current year withholdings = $31,000

Because Rob's current year withholdings are less than both of these amounts, he would be subject to an underpayment penalty if he does not make an estimated tax payment of $441 ($31,441, which is 90 percent of current year tax due, less $31,000 withholdings). If possible, Rob could instead increase his current year withholdings by $441 to avoid an underpayment penalty.

*Tax is computed utilizing the single ordinary tax rates for 2026, as provided in the tax rate table below:

Taxable Income	Tax Due
Not over $12,400	10% of taxable income
Over $12,400 but not over $50,400	$1,240 plus 12% of the excess over $12,400
Over $50,400 but not over $105,700	$5,800 plus 22% of the excess over $50,400
Over $105,700 but not over $201,775	$17,966 plus 24% of the excess over $105,700
Over $201,775 but not over $256,225	$41,024 plus 32% of the excess over $201,775
Over $256,225 but not over $640,600	$58,448 plus 35% of the excess over $256,225
Over $640,600	$192,979.25 plus 37% of the excess over $640,600

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Tax liability on $163,900 ordinary income before recommended actions:

- $17,966 plus 24% of the excess over $105,700
- $163,900 – $105,700 = $58,200
- $58,200 × 24% = $13,968
- $17,966 + $13,968 = $31,934

Tax liability on $156,100 ordinary income after recommended actions:

- $17,966 plus 24% of the excess over $105,700
- $156,100 – $105,700 = $50,400
- $50,400 × 24% = $12,096
- $17,966 + $12,096 = $30,062

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