

35. [LO 1] At the beginning of his current tax year, David invests \$12,000 in original issue U.S. Treasury bonds with a \$10,000 face value that mature in exactly 10 years. David receives \$700 in interest (\$350 every six months) from the Treasury bonds during the current year, and the yield to maturity on the bonds is 5 percent.
- How much interest income will he report this year if he elects to amortize the bond premium?
 - How much interest will he report this year if he does not elect to amortize the bond premium?

a. *If David elects to amortize the \$2,000 bond premium, he will use the constant yield method (similar to the effective interest method used to amortize bond premium under GAAP) to amortize the bond premium semiannually. Ultimately, he will report \$599 of interest income from the bond. The amortization table below reflects the required calculations:*

| <i>Column 1</i> <i>Semiannual Period</i> | <i>Column 2</i> <i>Adjusted Basis of Bond at Beginning of Semiannual Period</i> | <i>Column 3</i> <i>Interest Received</i> | <i>Column 4</i> <i>Premium Amortization (Column 3 – Column 5)</i> | <i>Column 5</i> <i>Reported Interest (Column 2 × .05 × .5)</i> |
|---------------------------------------------|------------------------------------------------------------------------------------|---------------------------------------------|----------------------------------------------------------------------|-------------------------------------------------------------------|
| <i>1</i> | <i>\$12,000</i> | <i>\$350</i> | <i>\$50</i> | <i>\$300</i> |
| <i>2</i> | <i>\$11,950</i> | <i>\$350</i> | <i>\$51</i> | <i>\$299</i> |
| <i>Yearly Total</i> | | <i>\$700</i> | <i>\$101</i> | <i>\$599</i> |

b. *If David does not elect to amortize the bond, he will simply report the entire \$700 payment he receives as interest income for the year.*

- 46.[LO 2] Grayson (single) is in the 24 percent tax rate bracket and has sold the following stocks in 2025:

| | Date Purchased | Basis | Date Sold | Amount Realized |
|---------|----------------|---------|------------|-----------------|
| Stock A | 1/23/2001 | \$7,250 | 7/22/2025 | \$4,500 |
| Stock B | 4/10/2025 | 14,000 | 9/13/2025 | 17,500 |
| Stock C | 8/23/2023 | 10,750 | 10/12/2025 | 15,300 |
| Stock D | 5/19/2015 | 5,230 | 10/12/2025 | 12,400 |
| Stock E | 8/20/2025 | 7,300 | 11/14/2025 | 3,500 |

- What is Grayson's net short-term capital gain or loss from these transactions?
- What is Grayson's net long-term gain or loss from these transactions?
- What is Grayson's overall net gain or loss from these transactions?
- What amount of the gain, if any, is subject to the preferential rate for certain capital gains?

- a. *Grayson's net short-term capital loss is \$300, which is the net of the short-term gains and losses for the year. This \$300 loss is the short-term capital gain of \$3,500 from Stock B (i.e., \$17,500 – \$14,000) less the short-term capital loss of \$3,800 from Stock E (i.e., \$3,500 – \$7,300).*
- b. *Grayson's net long-term capital gain is \$8,970, which is the net long-term gain less the long-term loss for the year. This is the net of the long-term capital gain of \$11,720 (i.e., \$4,550 from Stock C (\$15,300 – \$10,750) and \$7,170 from Stock D (\$12,400 – \$5,230)) less the long-term capital loss of \$2,750 from Stock A (\$4,500 – \$7,250).*
- c. *Grayson's net capital gain is \$8,670, which is the net short-term loss offset against the net long-term capital gain for the year because the signs are opposite. This \$300 short-term capital loss (from part a) is netted against the \$8,970 net long-term capital gain (from part b).*
- d. *Grayson's entire net capital gain of \$8,670 will be taxed at a preferential 15 percent tax rate because Grayson's tax bracket of 24 percent puts him above the maximum zero rate amount and below the maximum 15-percent rate amount.*

56.[LO 3] Mickey and Jenny Porter file a joint tax return, and they itemize deductions. The Porters incur \$2,000 in investment expenses. They also incur \$3,000 of investment interest expense during the year. The Porters' income for the year consists of \$150,000 in salary and \$2,500 of interest income.

- a. What is the amount of the Porters' investment interest expense deduction for the year?
- b. What would their investment interest expense deduction be if they also had a (\$2,000) long-term capital loss?
 - a. *The \$3,000 of investment interest expense is deductible to the extent of net investment income. Net investment income is \$2,500 (the same as investment income) because there are no deductible investment expenses to reduce gross investment income. Consequently, \$2,500 of the investment interest expense is deductible and \$500 is carried forward to next year.*
 - b. *If the Porters also have a \$2,000 long-term capital loss, their net investment income remains \$2,500 for purposes of determining the investment interest expense deduction. Capital losses are not included in the calculation of net investment income. Consequently, \$2,500 of the investment interest expense is deductible and \$500 is carried over to next year.*

59.[LO 4] Larry recently invested \$20,000 (tax basis) in purchasing a limited partnership interest in which he will have no management rights in the company. His at-risk amount is also \$20,000. In addition, Larry's share of the limited partnership loss for the year is \$2,000, his share of income from a different limited partnership was \$1,000, and he has \$3,000 of dividend income

from the stock he owns. How much of Larry's \$2,000 loss from the limited partnership can he deduct in the current year?

Before considering his \$2,000 loss, Larry's tax basis is \$20,000 and his at-risk amount is \$20,000. Therefore, the basis and at-risk hurdles do not apply. However, Larry still may not deduct \$1,000 of the \$2,000 loss because he only has \$1,000 of passive income for the year. Therefore, Larry has a \$1,000 passive activity loss carryover.