South - Western Federal Taxation 2026 Essentials of Taxation - Individuals and Business Entities 29th edition Nellen Solutions Manual

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Solution and Answer Guide

NELLEN, CUCCIA, PERSELLIN, YOUNG, SWFT ESSENTIALS OF TAXATION: INDIVIDUALS AND BUSINESS ENTITIES 2026, 9798214044163; CHAPTER 1: INTRODUCTION TO TAXATION

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PROBLEMS

1. (LO 1) Various answers are possible, including using the Key Terms at the end of each chapter [referring to the Glossary (Appendix C)], looking up the footnote resources to the Internal Revenue Code, using chapter features (e.g., Global Tax Issues, Bridge Discipline, Tax Planning Strategies, and Suggested Readings), examining the tax forms referenced in the chapters, and completing additional end-of-chapter assignments. All of these resources will help students engage more deeply with the materials and help their understanding.

2. (LO 3, 9) Some tax and nontax considerations James should investigate include the following:

   - State and local income taxes.
   - State and local sales taxes.
   - State and local property taxes.
   - Employee implications of the move (Will James lose current employees? Is the labor market better in the new location? Is cost of living lower or higher in new location?).
   - Logistics/transportation of products to customers (specifically document lower costs).
   - State infrastructure (better in new location?).
   - What is the cost of the move? What is the payback period/ROI for the move?
   - What are real estate prices for new facilities in the new location?
   - Are there any tax incentives from state or local agencies for relocating?

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3. (LO 2) A tax is *regressive* if it represents a larger percentage of the income of a low-income taxpayer relative to the income of a high-income taxpayer. Examples of regressive taxes include Federal employment taxes. A tax is *progressive* if it represents a larger percentage of the income of a high-income taxpayer relative to the income of a low-income taxpayer. The Federal income tax is an example of a progressive tax.

4. (LO 2, 6)

   a. $24,467 {[($131,750 − $103,350) × 24%] + $17,651.50}.

   b. 10%, 12%, 22%, 24%.

   c. 24%.

   d. 18.6% ($24,467 ÷ $131,750).

   e. 16.7% ($24,467 ÷ $146,750).

5. (LO 2) Tax rates can be measured several ways with each providing different information.

   a. Tax burdens are best measured using the effective rate. First, by taking into account the taxpayer's entire tax liability, unlike the marginal or statutory rate, the effective rate is a more comprehensive measure of tax burden. Second, by comparing a taxpayer's tax liability to its ability to pay, the effective rate avoids any problems with differences in the measure of the tax base across taxpayers.

   b. The best rate to use when assessing the return of a new investment is the marginal rate. The marginal rate focuses only on the tax applicable to a taxpayer's additional, or marginal, income, ignoring the tax related to other income the taxpayer may have.

6. (LO 2) Generally, a tax rate structure is determined by what happens to the tax rate as the tax base increases. However, tax rates can be measured several ways, potentially impacting how the rate structure might be viewed.

   a. With respect to its marginal rates, a sales tax is proportional. The statutory rate is the same regardless of the amount of purchases a taxpayer makes.

   b. With respect to its average rates, a sales tax is proportional as the percentage of sales paid in taxes remains the same regardless of the tax base, the amount of purchases a taxpayer makes.

   c. With respect to its effective rates, the sales tax can best be described as regressive. Taxpayers with higher income and, therefore, ability to pay the tax typically must spend less of that income with a greater ability to save or invest. By spending a smaller portion of their income, higher-income taxpayers will pay a smaller portion of their income in sales taxes.

7. (LO 3)

   a. The parsonage probably was not listed on the property tax rolls because it was owned by a tax-exempt church. Apparently the taxing authorities are not aware that ownership has changed.

   b. Ethan should notify the authorities of his purchase. This will force him to pay back taxes but may eliminate *future* interest and penalties.

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8. (LO 1, 2) (See Digging Deeper 1.) As to Adam Smith's canon on economy, the Federal income tax yields a mixed result. From the standpoint of the IRS, economy exists as collection costs are nominal (when compared with revenue generated). The government's cost of collecting Federal taxes amounts to less than one-half of 1 percent of the revenue collected. Economy is not present, however, if one looks to the compliance effort and costs expended by taxpayers. According to recent estimates, about 56% of individual taxpayers who file a return pay a preparer, and one-third purchase tax software.

9. (LO 3) Jang probably will be required to pay the Washington use tax if, and when, he applies for Washington license plates. In this case, the use tax probably is the same amount as the Washington sales tax.

10. (LO 3) Although the Baker Motors bid is the lowest, from a long-term financial standpoint, it is the likely the best. The proposed use of the property by the state and the church probably will make it exempt from the school district's ad valorem property tax. The car dealership, on the other hand, would be subject to property taxes, which would likely be in an amount, over time, that would exceed the difference in the lower sales price.

11. (LO 3) Possible explanations are that Sophia made capital improvements (e.g., added a swimming pool) to her residence and her parents became retirees (e.g., reached age 65).

12. (LO 5, 9)

SWFT, LLP
5191 Natorp Boulevard
Mason, OH 45040

December 5, 2025

Cynthia Clay
1206 Seventh Avenue
Fort Worth, TX 76101

Dear Cynthia:

I am writing this letter to help you decide on what form of entity to choose for your new food delivery business. In our phone conversation, you indicated that you expect to have losses for the first two years in this business and then make substantial profits in subsequent years. You and Marco also indicated that you are concerned about potential personal liability.

While I can't make a conclusive recommendation based on the information you have given me, I can provide you with some general guidelines that should simplify your decision. First, given your concern about personal liability, a partnership does not appear to be a desirable option (you would both be personally liable for any injuries to customers). Similarly, given your expectation of losses in the first two years, it does not appear that a C corporation would be a desirable choice, at least initially. This is because any losses in the corporation could only be used to offset future corporate profits—you could not use the losses to immediately offset your personal tax liability.

Thus, two choices exist which provide limited liability and deductibility of losses on your personal income tax return. These are the S corporation and the limited liability company. If you choose an S corporation, we would probably convert the entity to a C corporation when the business becomes profitable. At that point, profits would be

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taxed at the C corporation rate. A second tax would be levied on your personal income tax return for any dividends paid by the corporation once it achieves C status. In contrast, limited liability companies are taxed like partnerships—all income would be taxed on your personal income tax return in profitable years. The relative desirability of each of these two forms depends on a number of factors. One of the most important factors in your situation is the relationship between your personal tax rate and the tax rate of a C corporation. If you are in a high tax bracket and if the income in the business is sufficiently low, you might be best off choosing the S corporation. Alternatively, if you expect the business to generate a sufficiently large profit each year, it might be best to choose the limited liability company. The qualified business income deduction for income from flow-through entities along with the flat tax rate of 21% that applies to corporations also must be taken into consideration.

If you would like me to give you a clearer recommendation, we should meet at your earliest convenience. If you have any additional questions, please call me.

Best regards,

Julian Jackson, CPA

13. (LO 5, 8)

a.

	Year 1	Year 2	Year 3
Corporate Tax Liability			
Sales revenue	$150,000	$320,000	$600,000
Cash expenses	(30,000)	(58,000)	(95,000)
Depreciation	(25,000)	(20,000)	(40,000)
Taxable income	$ 95,000	$242,000	$465,000
Corporate tax liability	$ 19,950	$ 50,820	$ 97,650
Cash Available for Dividends			
Sales revenue	$150,000	$320,000	$600,000
Tax-free interest income	5,000	8,000	15,000
Cash expenses	(30,000)	(58,000)	(95,000)
Corporate tax liability	(19,950)	(50,820)	(97,650)
Cash available for dividends	$105,050	$219,180	$422,350
Ashley's After-Tax Cash Flow			
Dividend received	$105,050	$219,180	$422,350
Tax on dividend at 15% rounded	(15,758)	(32,877)	(63,353)
After-tax cash flow	$ 89,292	$186,303	$358,997
PV of cash flow*	$ 79,729	$148,521	$255,534
Total present value	$483,784		

*Present value factors (.8929, .7972, .7118) from Appendix E.

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b.

	Year 1	Year 2	Year 3
Individual Tax Liability			
Sales revenue	$150,000	$320,000	$600,000
Cash expenses	(30,000)	(58,000)	(95,000)
Depreciation	(25,000)	(20,000)	(40,000)
Taxable income	$ 95,000	$242,000	$465,000
Individual tax liability**	$ 23,750	$ 60,500	$116,250

**Rate = 25%

Ashley's After-Tax Cash Flow			
Sales revenue	$150,000	$320,000	$600,000
Tax-free interest income	5,000	8,000	15,000
Cash expenses	(30,000)	(58,000)	(95,000)
Individual tax liability	(23,750)	(60,500)	(116,250)
After-tax cash flow	$101,250	$209,500	$403,750
PV of cash flow*	$ 90,406	$167,013	$287,389
Total present value	$544,808		

*Present value factors (.8929, .7972, .7118) from Appendix E.

c. If Ashley wants to have access to all available cash from the business, then she will have to pay out dividends annually. As seen in the answers to parts a. and b. above, the present value of future cash flows is substantially greater if she does not incorporate under this assumption. Alternatively, if she does not need to pay out dividends, then she may be better off by incorporating, since only the corporate tax will be incurred, which is less than her individual tax. The value of her stock will increase and she then can sell the stock at a later date at favorable capital gains rates.

14. (LO 1)

PowerPoint presentations will vary. In favor of high progressivity:

- Ability to pay.
- Fairness of result.
- Benefits of government skew toward those at upper-income levels.

Contrary to high progressivity:

- Discouragement of work and innovation.
- Unfairness of result.
- Civic engagement by those at lower-income levels requires "skin in the game."

15. (LO 3)

a. In terms of taxpayer compliance, an ad valorem tax on personalty is less desirable than one on realty. However, a tax on business personalty, such as inventory, is to be preferred over one on personal use (i.e., nonbusiness) personalty.

b. A tax on stock and bonds would be too easily avoided. The taxing authority would have no means of ascertaining ownership of these assets.

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c. Poor taxpayer compliance is to be expected for any tax on personal use personalty. However, if boats had to be periodically licensed (e.g., safety inspection), this could provide the taxing authority with a means of discovering unreported boat ownership.

16. (LO 2, 6)

a. Economic justification. The tax law addresses concerns about the use of fossil fuels—in terms of both reliance on foreign oil and the need to ease the problem of climate change.

b. Economic justification. The tax law addresses concerns about the use of fossil fuels—in terms of both reliance on foreign oil and the need to ease the problem of climate change.

c. Economic justification. Research and development activities are encouraged by allowing immediate or faster write-off of these expenditures.

d. Social justification. The charitable deduction helps fund private organizations and causes that are operated in the interest of the general welfare. This relieves government of the need for considerable public funding.

e. Economic justification. Known as the S election, the provision encourages small businesses to operate in the corporate form without suffering all of the tax disadvantages of the regular (C) corporation.

17. (LO 4, 6)

a. Social considerations explain the credit. It is socially desirable to encourage parents to provide care for their children while they work.

b. These deductions raise the issue of preferential tax treatment for homeowners—taxpayers who rent their personal residences do not receive comparable treatment. Even so, the encouragement of home ownership can be justified on economic and social grounds.

c. Social considerations justify that activities deemed contrary to public policy should not result in tax savings.

d. The NOL carryforward provision is an equity consideration designed to mitigate the effect of the annual accounting period concept.

e. The installment method of reporting gain is consistent with the wherewithal to pay concept—the seller is taxed when the payments are made by the purchaser.

f. The exclusion from Federal income taxation of interest from state and local bonds can be justified largely on political considerations. Political goodwill is generated by allowing state and local jurisdictions to secure financing at a lower cost (i.e., interest rate) due to favorable Federal income tax treatment.

g. The treatment of prepaid income is justified under the wherewithal to pay concept. It also eases the task of the IRS as to administration of the tax law.

18. (LO 3) (See Digging Deeper 3.) A value added tax (VAT) taxes the increment in value as goods move through the production and manufacturing stages to the marketplace.

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Although the tax is paid by the producer, it is reflected in the selling price of the goods. Therefore, a VAT is a tax on consumption.

A national sales tax taxes numerous transactions and is collected on the final sale of goods and services to the consumer. Consequently, it is collected from the consumer and not the producer of the product as does a VAT.

In terms of taxpayer compliance, a VAT is preferable to a national sales tax. Without significant collection efforts, a national sales tax could easily be circumvented or avoided in many ways (e.g., resorting to a barter system of doing business).

19. (LO 3) An estate tax is imposed on a decedent's right to pass property to heirs at death. It is paid by the decedent's estate. An inheritance tax is imposed on an heir's right to receive property from a decedent. It is imposed on the heir.

    a. Some states impose both an estate tax and an inheritance tax. Some states (e.g., Florida and Texas) levy neither tax.

    b. The Federal government imposes an estate tax.

20. (LO 2, 6) Students' e-mails may vary. Build interaction into the exercise wherever possible, asking the student to send and receive e-mail in a professional and responsible manner.

21. (LO 3, 4, 8) If Mike is drafted by a team in one of the listed states, he will escape state income tax on income earned within that state (e.g., training camp, home games). He will not, however, escape the income tax (state and local) imposed by jurisdictions where he plays away games. Called the "jock tax," it is applied to out-of-state athletes and entertainers.

22. (LO 2, 6) The checkoff boxes add complexity to the return and mislead taxpayers into presuming that they are not paying for the donation.

23. (LO 8) Tax evasion refers to the illegal nonpayment of taxes. Assuming the corporation made the investments it claims and that those investments qualified for the incentive, there was no evasion involved. Instead, the corporation's behavior is better described as tax avoidance, reducing its tax liability through legal means. In fact, given the purpose of the incentive, it can be argued that the corporation is engaging in activity foreseen and encouraged by Congress.

24. (LO 9) The SSTSs are available at: **aicpa-cima.com/resources/download/revised-statements-on-standards-for-tax-services-no-1-4-1-1-2024**.

    a. While it is fine and usually beneficial to use tax preparation software, the preparer should be sure they understand how the software works and verify at least a sampling of items on returns and review all returns for completeness and accuracy. For a new tax calculation such as the renter's credit, the preparer should be sure they understand how the credit is computed and then apply the provision to a variety of fact patterns (e.g., single taxpayers versus married taxpayers) without tax software and compare it to the software's calculation of the credit to ensure that the software is computing the credit correctly.

    b. As noted in SSTS 1.4, members are responsible for their work product and should take "reasonable steps" to be sure any tools they use "are appropriate for the

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intended purpose." A preparer should not rely on artificial intelligence (AI) to produce a tax answer for a client. If appropriate in terms of security and privacy, AI can be used, similar to conducting research, but as with any other research tool or resource, the preparer must still fully analyze and review the results for accuracy, completeness, and whether current tax law is appropriately applied.

Bridge Discipline Problems

1. Solutions may vary among students.
2. Solutions may vary among students.
3. Solutions may vary among students.
4. When taxes become "too high," the rate of tax cheating increases, because the payoff from misconduct increases. Property and transaction taxes are difficult to cheat on, as the tax base is easily detectible, while cheating on taxes on income and asset transfers may be more easily accomplished, and enforcement activities by the taxing agency become more expensive. High rates of tax cheating can lead to several undesirable consequences.
   - A "conspicuous consumption" society, wherein taxpayers use their tax underpayments to increase their lifestyles in a public fashion.
   - A loss of confidence in the self-assessment system, such that certain levels of cheating are assumed to occur, and the number of cheaters increases.
   - The "missing revenue" keeps the government from delivering the goods and services that the taxes are supposed to pay for.
   - Political gridlock can occur when it becomes impossible to raise tax rates high enough, or broaden the tax base enough, to offset the cheaters' "missing revenue."
5. a. To encourage pension plans is to stimulate saving (economic consideration). Also, it provides security from the private sector for retirement to supplement public programs which tend to provide lesser benefits (social considerations). An opposing consideration is that only higher income individuals are able to fully fund their pension plans and, thus, gain the greater tax benefit from the favorable rules for retirement savings.

   b. To make education more widely available is to promote a socially desirable objective. A better educated workforce also serves to improve the country's economic capabilities. As a result, education tax incentives can be justified on both social and economic grounds. A weakness in the current incentives is that they are only for college education, rather than also in preparation for other careers including health care, personal care, construction, and skilled trades (e.g., mechanics, electricians, and plumbers).

   c. The encouragement of home ownership can be justified on both social and economic grounds. For example, if a person owns a home and has no mortgage by the time they retire, their monthly living expenses will be lower. An opposing consideration to the tax breaks for home ownership is that the mortgage interest deduction applies to debt up to $750,000, thus providing a greater tax break to higher income individuals who can qualify for this large of a mortgage. Also, renters

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indirectly pay property taxes through their rent, but receive no tax deduction for that indirect payment. Finally, the home ownership tax breaks today apply once the home is acquired; there are no tax incentives to help an individual buy a home (such as a first-time homebuyer tax credit).

Research Problems

These research problems require that students utilize online resources to research and answer the questions. As a result, solutions may vary among students and courses. You should determine the skill and experience levels of the students before assigning these problems, coaching where necessary. Encourage students to use reliable websites and blogs of the IRS and other government agencies, media outlets, businesses, tax professionals, academics, think tanks, and political outlets to research their answers.

1. An example of a sweetened beverage tax proposal is H.R. 2772 (117th Congress), the SWEET Act. Proposals also exist in a number of states and cities. Some cities, including Berkeley, California, Philadelphia, Pennsylvania, and Boulder, Colorado, have already enacted soda taxes. Considerations in analyzing these proposals include issues of regressivity (an equity and fairness issue), complexity of definitions, burden of enforcement, and neutrality in affecting decision making. Cook County, Illinois (Chicago) passed and then repealed a sweetened beverage tax due to a number of these issues.

2. Each of the Big Four firms has information on data analytics and how it can be used for tax purposes:

   - **pwc.com/us/en/services/consulting/cloud-digital/data-analytics.html**
   - **kpmg.com/xx/en/what-we-do/services/tax/global-indirect-tax-services/data-and-analytics.html**
   - **ey.com/en_us/big-data-analytics**
   - **www2.deloitte.com/us/en/pages/deloitte-analytics/solutions/deloitte-analytics.html**

   Students should also find how the IRS and state tax agencies are using big data to improve audit selection and enforcement. For example, see IRS information in the Internal Revenue Manual (IRM) 1.1.18, Research, Applied Analytics and Statistics Division at:

   - **irs.gov/irm/part1/irm_01-001-018**

3. The Safeguards Rule was created as part of the Gramm-Leach-Bliley Act in 1999 (P.L. 106–102). The FTC summarizes this rule as follows: “The Safeguards Rule requires financial institutions under FTC jurisdiction to have measures in place to keep customer information secure. In addition to developing their own safeguards, companies covered by the Rule are responsible for taking steps to ensure that their affiliates and service providers safeguard customer information in their care.” This rule applies to all paid return preparers.

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- **ftc.gov/business-guidance/resources/ftc-safeguards-rule-what-your-business-needs-know**

IRS Publication 4557 includes several actions preparers should take to protect client data and meet the Safeguards Rule. In reviewing student answers, confirm that they understand the Safeguards Rule and why a preparer obtaining or renewing a PTIN is asked to confirm that they have a data security plan. The publication lists numerous actions, consider whether the three plan elements the student describes are among the most important.

In August 2022, the IRS Security Summit released a document with explanation and templates to help practitioners update or create a security plan. See IR–2022–147 (August 9. 2022) at **irs.gov/newsroom/security-summit-releases-new-data-security-plan-to-help-tax-professionals-new-wisp-simplifies-complex-area**. The template provided in August 2022 for a Written Information Security Plan (WISP) was updated in August 2024. See IR–2024–208 (August 13, 2024) at **irs.gov/newsroom/irs-security-summit-release-new-written-information-security-plan-to-help-tax-pros-protect-against-identity-thieves-data-risks**.

4. Circular 230 § 10.35 on competence states that a practitioner may become competent for an engagement matter in a variety of ways, including by consulting with experts or studying the law. As a result, if someone at the firm gains a better understanding of virtual currency transactions, the record keeping needed to determine the tax consequences of over 2,500 trades and also consider other rules (e.g., the trader versus investor status of the client), they can accept this client. If the firm is not able to become competent, they may not accept this potential new client.

Solutions To Becker CPA Review Questions

1. **Choice "a" is correct.** Treasury Department Circular 230 is the IRS publication that addresses the practice before the IRS of practitioners with regard to the rules governing the authority to practice before the IRS, the duties and restrictions relating to practice before the IRS, the sanctions for violations of the regulations, and the rules applicable to disciplinary proceedings.

   Choice "b" is incorrect. Treasury Department Circular 230 does not provide guidance for practicing before the U.S. Tax Court but provides guidance for practicing before the IRS.

   Choice "c" is incorrect. Treasury Department Circular 230 does not address presenting before state boards of accountancy but provides guidance to practitioners on practicing before the IRS.

   Choice "d" is incorrect. The standards for the financial reporting of income taxes are found in Accounting Standards Codification (ASC) Section 740, not Treasury Department Circular 230.

2. **Choice "b" is correct.** All of the other choices are required conduct by a preparer of an income tax return. A preparer must make a reasonable attempt to obtain the necessary information from the taxpayer and make inquiries if the information appears to be incorrect or incomplete. The preparer is not responsible for verifying taxpayer-

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provided information. The taxpayer is actually responsible for providing the preparer with accurate information.

Choices “a,” “c,” and “d” are incorrect, as they are all required conduct by a preparer of an income tax return. A preparer must:

- Legally minimize the taxpayer’s tax liability and abide by the tax code.
- Make a reasonable effort to obtain the necessary information from the taxpayer and make inquiries if the information appears to be incorrect or incomplete.
- Recommend a tax return position only if the preparer has a good faith belief that the position has a realistic possibility of being sustained if challenged.
- Notify the taxpayer if he or she becomes aware of a tax return error.
- Inform the taxpayer on how to correct the situation of the taxpayer having failed to file a tax return.
- Consider withdrawing from the engagement if the taxpayer does not correct the error or file the return the preparer advised him or her about.
- Not inform the IRS without the taxpayer’s permission.

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Instructor Guide

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CHAPTER OBJECTIVES

The following objectives are addressed in this chapter:

1.1 Explain the importance of taxes, how to study taxes, and how tax and finance professionals work with taxes.

1.2 Explain the components of a tax.

1.3 Identify the various taxes affecting business entities and individuals.

1.4 Describe the basic tax formula for individuals and business entities.

1.5 Explain the tax systems that apply to business entities and their owners.

1.6 Explain the economic, social, equity, political, and compliance considerations that underlie the tax law.

1.7 Describe the influence of the IRS and the courts on the Federal tax system.

1.8 Explain some of the ethical guidelines involved in tax compliance and planning.

1.9 Identify tax planning opportunities using a general tax-planning framework.

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CHAPTER OUTLINE

In the outline below, each element includes references (in parentheses) to related content. "CO CH.##" refers to the chapter objective; "PPT Slide #" refers to the slide number in the PowerPoint deck for this chapter (provided in the PowerPoints section of the Instructor Resource Center); and, as applicable for each discipline, accreditation or certification standards ("BL 1.3.3"). Introduce the chapter and use the Ice Breaker in the PPT if desired, and if one is provided for this chapter. Review learning objectives for Chapter 1 (PPT Slides 2–4).

I. Taxes in Our Lives (1.1, PPT Slides 10–16)

   i. Various types of taxes, such as income, sales, property, and excise taxes, come into play in many of the activities of individuals, businesses, nonprofit entities (like charities), and governments themselves.
   ii. Ultimately, all taxes are paid by individuals. The corporate income tax, for example, is paid directly by corporations, but it really is paid indirectly by individuals in their capacity as customers, investors (owners), or employees; the taxes are passed along to individuals through higher prices for products and services, lower dividends, and/or lower wages.
   iii. Federal, state, and local elections often include initiatives that deal with taxation. Candidates running for office often have ideas on tax changes they would like to make if they are elected.

a. The Relevance of Taxation to Accounting and Finance Professionals
   i. A corporation may devote about 25% of its net income to pay income taxes, plus it is subject to employment taxes, property taxes, sales taxes, and various excise taxes. Corporations with international operations are subject to taxation in other countries.
   ii. Given its significance, taxation is a crucial topic for accounting and finance professionals serving individuals, businesses, and nonprofit entities. They must understand the various types of taxes to assist effectively with:
      1. Compliance: Ensure that the business files all tax returns and makes all tax payments on time. Mistakes and missed due dates will lead to penalties and interest expense.
      2. Planning: Help a business to apply favorable tax rules, like deferring income and obtaining tax credits, to minimize tax liability (and maximize owner wealth). The time value of money concept also is important here, as is coordinating tax planning with other business goals to maximize earnings per share.
      3. Financial reporting: Financial statements include a variety of tax information, including income tax expense on the income statement and deferred tax assets and liabilities on the balance

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sheet. Footnotes to the financial statements report various tax details, including the company's effective tax rate.

4. Environmental, Social, and Governance (ESG) reporting: A growing trend in corporate reporting is to address various business sustainability and responsibility matters and report environmental, social, and governance activities and impact. This reporting can include taxes paid in each country (part of "country-by-country reporting"), reconciliation between taxes paid and the statutory tax rate on financial statement profits, financial assistance received from governments via tax deductions and credits, and an explanation of the corporation's tax policy and strategy.
5. Controversy: Assist when the taxpayer interacts with a tax agency (like the IRS). The IRS and state and local tax agencies regularly examine (audit) tax returns to verify that taxes were properly computed and paid. Tax practitioners may represent a taxpayer before the IRS (or other tax agency) to assist with an audit or to provide answers to questions the tax agency has asked the taxpayer.
6. Cash management: Taxes must be paid on time to avoid penalties and interest. Income taxes must be estimated and paid quarterly and reconciled on the annual return. Other taxes may be due weekly, monthly, quarterly, or semiannually. Businesses must be sure they have the funds ready when the taxes are due and have procedures to track due dates.
7. Data analysis: With a majority, if not all, of a company's records maintained in digital form, there are opportunities to use this information to enhance profits, better understand the customer base, and improve and understand the information from a tax perspective. Tax practitioners often need skills in data analysis and visualization to identify samples for both internal and external audits, find ways to identify the products and services subject to sales tax in different states, and extract tax data to help inform other business functions, such as where to locate a new sales office. The IRS and state tax agencies also use data analysis to help identify potential audit issues.
8. Tax advocacy: Taxpayers and tax practitioners can add tremendous value to the improvement and evolution of our tax laws by sharing their knowledge, experiences, and ideas with lawmakers and tax agencies. This input might take the form of comment letters, testimony before legislative committees (delivered in person or submitted for the record), or individual correspondence and meetings.

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iii. The level and depth of tax knowledge needed for any accounting or tax professional depends on their specific job.
iv. It is essential to maintain a balanced perspective when working with tax systems. While taxation is often a significant factor in many decisions, it remains one of many when considering how best to achieve one's goals.

b. Studying Taxation
   i. The goal of studying taxation is to be able to recognize issues or transactions that have tax implications and to determine what those implications are.
   ii. Taxation is an important and exciting topic due to its relation to the government's ever-changing economic, social, and political goals and its significance to the bottom line of a company and an individual's finances.
   iii. One should focus on understanding the rules and the why(s) behind them rather than only memorizing numerous rules and terms. Aiming for understanding, rather than memorization, will make your journey into the world of taxation interesting and meaningful, and prepare you well for recognizing and managing the tax issues that will inevitably arise in your accounting or finance career.

c. Individuals and Taxes
   i. The diagram on page 1-5 in the text illustrates the many ways individuals interact with taxes.

II. The Structure of Tax Systems (1.2, PPT Slides 17–23)

   i. Any tax consists of at least two components: the tax base and the tax rate. The tax base is a measure of what is taxed, while the tax rate captures how and to what extent the base is taxed. The resulting tax liability is the product of the tax base and the tax rate. In some cases, credits may be available to reduce a taxpayer's liability.

a. Tax Bases
   i. The tax base is a measure of what is subject to tax. Most taxes are levied on one of four kinds of tax bases.
      1. Transactions (including sales or purchases of goods and services).
      2. Property or wealth (including ownership of specific kinds of property as well as the transfer of property by gift or at death).
      3. Privileges and rights (including the ability to do business as a corporation, the right to work in a certain profession, and the ability to move goods between countries).
      4. Income.

b. Tax Rates

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i. Tax structures can be progressive, proportional, or regressive.
ii. A tax rate is progressive if the rate increases as the tax base increases. The Federal income tax imposed on individuals is an example of a progressive tax.
iii. Currently, the tax rates increase from 10% to 37% as taxable income (the tax base) increases.
iv. A tax is proportional (sometimes referred to as *flat*) if the rate of tax is constant, regardless of the size of the tax base. State retail sales taxes are proportional.
v. Regressive tax rates decrease as the tax base increases.
   1. Taxes are rarely regressive, at least with respect to their statutory rates.
   2. Federal employment taxes, such as FICA and FUTA, can be considered regressive as the tax rate is reduced to zero for amounts over a given level of the tax base.
vi. When discussing tax rates, people are often referring to the statutory tax rate. Statutory rates are those specified in the law.
vii. For tax planning purposes, the marginal tax rate may be more relevant than the statutory rate. The marginal tax rate is the tax rate applicable to the taxpayer's next, or marginal, dollar of the tax base (the next dollar of taxable income if considering income taxes).
viii. The average tax rate, a taxpayer's total tax liability divided by their total tax base, is often used to compare tax burdens across different taxpayers or a taxpayer's tax burden across time.
ix. The effective tax rate is equal to a taxpayer's tax liability divided by the taxpayer's ability to pay regardless of how the tax base is technically defined. By avoiding factors that may affect the tax base but have no impact on a taxpayer's ability to pay the tax, the effective rate is often considered a better measure of a taxpayer's (relative) tax burdens.
x. The interpretation and description of a tax's rate structure may be impacted by the rate being considered.

c. Incidence of Taxation
   i. A taxpayer's tax burden includes not only taxes paid directly (like income taxes) but also taxes paid indirectly. Often, the incidence of various taxes directly paid by businesses is on the final consumer of goods and services.
   ii. In evaluating tax systems, it is important to consider taxes paid both directly and indirectly in order to understand the effect of taxes on individuals.

III. Types of Taxes (1.3, PPT Slides 24–49)

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i. Taxes can be categorized into three broad types: transaction taxes, valuation or wealth taxes, and income taxes.

a. Transaction Taxes

i. Federal Excise Taxes. Examples of Federal excise taxes include those imposed on tobacco, gasoline, telephone usage, air travel, and alcohol.

1. Since World War II, the role of excise taxes in financing the Federal government has steadily declined, falling from about 30 to 40% of revenues just prior to the war to about 2% now.
2. Currently, trucks, trailers, tires, liquor, tobacco, firearms, certain sporting equipment, medical devices, and air travel all are subject to Federal excise taxes.
3. Excise taxes extend beyond sales transactions; they also are levied on privileges and rights. Many excise taxes are intended to influence social or economic behavior.
4. The bases used for Federal excise taxes are as diverse as the goods that are taxed (i.e., by the gallon, by the dose, by the price paid per ticket, etc.). Some are levied on producers, some on resellers, and some on consumers.
5. With the exception of Federal excise taxes on alcohol, tobacco, and firearms, Federal excise taxes are due at least quarterly, when the Federal excise tax return (Form 720) is filed.

ii. State and Local Excise Taxes.

1. Many states levy excise taxes on the same items taxed by the Federal government. For example, most states have excise taxes on gasoline, liquor, and tobacco. The tax on specific goods can vary dramatically among states.
2. Other goods and services subject to state and local excise taxes include admission to amusement facilities; hotel occupancy; rental of other facilities; and sales of playing cards and prepared foods. Some counties impose a tax on transfers of property that require recording of documents (such as real estate sales and sales of stock and securities).
3. In recent years, two types of excise taxes have become increasingly popular at the local level: hotel occupancy tax and the rental car “surcharge.” These taxes apply primarily to visitors who cannot vote, and so are a political windfall and often serve as a means of financing special projects that generate civic pride.

iii. General Sales Tax. The broad-based general sales tax is a major source of revenue for most state and local governments. It is used in all but five states (Alaska, Delaware, Montana, New Hampshire, and Oregon).

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1. The sales tax typically employs a proportional statutory tax rate and includes retail sales of tangible personal property (and occasionally personal services) in the base.
2. Some states exempt medicine and groceries from the base, and sometimes tax rates vary with the good being sold.
3. Local general sales taxes, over and above those levied by the state, are common.
4. For various reasons, some jurisdictions temporarily suspend the application of a general sales tax. The prevalent justification for these sales tax holidays is to reduce the cost of certain necessities, such as back-to-school items or hurricane preparedness items.

iv. Use Taxes. Every state that imposes a general sales tax also applies a use tax. The purpose of the use tax is to prevent the avoidance of the sales tax through the purchase of items in other states that have no sales taxes or that provide for lower rates.

v. Value Added Tax. The value added tax (VAT) is a variation of a sales tax but is levied at each stage of production on the value added by the producer.
   1. A VAT is used by almost all countries around the world; the United States is one of the few countries that does not use a VAT.
   2. The tax typically serves as a major source of revenue for governments that use it.

vi. Federal Customs Duties. Customs duties or tariffs can be characterized as a tax on the right to move goods across national borders.
   1. These taxes provided most of the revenues needed by the Federal government during the nineteenth century. Tariffs and excise taxes alone paid off the national debt in 1835 and enabled the U.S. Treasury to pay a surplus of $28 million to the states.
   2. In recent years, tariffs have acted more as an instrument for carrying out protectionist policies and to generate revenue.
   3. History shows that tariffs often lead to retaliatory action on the part of the nation or nations affected.

vii. State and Local Business Taxes.
   1. State and local governments may impose taxes or fees on businesses operating in their jurisdiction. For example, many cities impose business license taxes.
   2. Occupational taxes are applicable to various trades or businesses, such as a liquor store license, a taxicab or shared-ride permit, or a fee to practice a profession such as law, medicine, or

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accounting. Most of these are not significant revenue producers and fall more into the category of licenses than taxes.

ix. Severance Taxes. Severance taxes are based on the extraction of natural resources (e.g., oil, gas, iron ore, and coal). They are an important source of revenue for many states.

b. Valuation and Wealth Transfer Taxes

i. The Federal Estate Tax. Total collections of Federal estate and gift tax revenues in 2023 were over $35 billion. This represents less than 1% of total Federal tax collections.

1. The Federal estate tax was intended to prevent large concentrations of wealth from being kept within a family for many generations. Whether this objective has been accomplished is debatable because estate taxes can be substantially reduced (or deferred for decades) through careful tax planning activities.

(a) Determination of the estate tax base begins with the decedent's gross estate, which includes property the decedent owned at the time of death.

(b) Deductions from the gross estate in arriving at the taxable estate include funeral and administration expenses, certain taxes, debts of the decedent, and transfers to charitable organizations.

(c) A marital deduction is available for amounts passing to a surviving spouse (a widow or widower).

(d) The estate tax is determined by applying the progressive unified transfer tax rates, ranging from 18% to 40% (see Appendix A), to the sum of the taxable estate and the taxable gifts made by the decedent during their lifetime. The tentative liability is reduced by a variety of credits to arrive at the amount due.

(e) For 2025, the unified transfer tax credit effectively exempts taxable estates up to $13,990,000 from tax, meaning that the vast majority of estates pass tax-free to the heirs.

ii. State Taxes at Death. State taxes on transfers at death may include an inheritance tax, an estate tax, or both. The taxes will differ according to whether the tax is imposed on the heirs or on the estate. Some states allow a zero rate of tax on amounts passing to a surviving spouse.

iii. Gift Tax. The Federal gift tax is imposed on transfers made during one's life, rather than at death.

1. The Federal gift tax is intended to complement the estate tax. The gift tax base is the sum of all taxable gifts made during one's lifetime.

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2. The Federal gift tax and the Federal estate tax are unified. The transfer of assets by a decedent at death effectively is treated as a final gift under the tax law.
3. Annual taxable gifts are determined by reducing the fair market value of gifts given by an annual exclusion of $19,000 per donee; this amount does not use up any of the lifetime exclusion. A married couple can elect gift splitting, which enables them to transfer twice the annual exclusion ($38,000) per donee per year, before eroding the lifetime exclusion amount.
4. Taxable gifts are reduced by deductions for gifts to charity and to one's spouse (the marital deduction).
5. Gifts for medical and educational purposes may be exempt from the gift tax.

iv. Property Taxes. A property tax can be a tax on the ownership of property or a tax on wealth depending on the base used. Most property taxes in the United States are taxes on wealth; they use value as a base.

1. Value-based property taxes are known as ad valorem taxes.
2. Taxes on Realty. Property taxes on real property, or realty, are used exclusively by states and their local political subdivisions such as cities, counties, and school districts.
   (a) Realty is land and anything permanently attached to land, and personalty encompasses all assets that are not realty.
   (b) Common characteristics of ad valorem taxes on realty include the following:
      - States may have a homestead exemption, which makes some portion of the value of a personal residence exempt from tax.
      - Lower taxes may apply to a residence owned by a taxpayer age 65 or older.
      - Some jurisdictions extend immunity from tax for a specified period of time (a tax holiday) to new or relocated businesses.
      - Some states provide for lower valuations on property dedicated to agricultural use or other special uses (e.g., wildlife sanctuaries).
      - States typically exempt property used by charitable and religious organizations.
3. Taxes on Personalty. Personal property, or personalty, encompasses all assets that are not realty. Both realty and personalty can be either business use or personal use property.
   (a) Personalty also can be classified as tangible property or intangible property.

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(b) The following generalizations may be made concerning the property taxes on personalty:
- Generally, for individuals, vehicles are the only non-realty personal use assets subject to property tax. The value of a vehicle typically is established by a schedule based on the vehicle's age and make/model. Usually, any vehicle property tax is assessed and collected along with vehicle license or registration fees.
- Generally, businesses are assessed property taxes on equipment and other tangible property, although many states do not tax inventory.
- Some jurisdictions impose an ad valorem property tax on intangibles, like stocks and bonds.

c. Income Taxes

i. Income taxes are levied by the Federal government, most states, and some local governments. Most jurisdictions attempt to ensure the collection of income taxes by requiring certain pay-as-you-go procedures.

ii. The Structure of the Federal Income Tax. (1.4, PPT Slides 50–69) The basic Federal income tax formula is similar for all taxable entities. This formula is shown in Exhibit 1.1 in the text.

1. Taxable income is based on a taxpayer's net income. All gross income is subject to tax unless specifically excluded from the tax base.
2. While most business expenses are deductible, several are prohibited.
3. For individuals, deductions are separated into two categories—deductions *for* adjusted gross income (AGI) and deductions *from* AGI. An overview of the individual income tax formula is provided in Exhibit 1.2 in the text.
4. Individual income tax rates range from 10% to 37%. Estates and trusts are also subject to income taxation, with rates ranging from 10% to 37%.
5. Partnerships, qualifying small business corporations, and some limited liability companies are not subject to the Federal income tax. However, they are tax reporting (or "pass-through") entities, required to report to the IRS and their owners the income they generate.

iii. Employment Taxes.

1. Both Federal and state governments impose an additional tax on the salaries and wages paid to employees.

(a) There are two major employment taxes on the Federal side: FICA and FUTA. These employment taxes represent a major source of funds.

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(b) The FICA tax accounts for more than one-third of revenues in the Federal budget, second only to the income tax in its contribution.
(c) The FUTA tax provides funds to state unemployment benefit programs.
(d) Most state employment taxes are similar to the FUTA tax, with proceeds used to finance state unemployment benefit payments.

2. FICA Taxes. The FICA tax has two components: old age, survivors, and disability insurance payments (commonly referred to as Social Security) and Medicare health insurance payments.
   (a) The Social Security tax rate is 6.2% (for both employee and employer), and the Medicare tax rate is 1.45% (for both employee and employer). The maximum base for the Social Security tax is indexed annually for inflation. The base is $176,100 for 2025 and $168,600 for 2024. There is no ceiling on the base amount for the Medicare tax.
   (b) Payments usually are made through weekly or monthly electronic payments or deposits to a Federal depository.
   (c) An additional 0.9% Medicare tax is imposed on earned income (including self-employment income) above $200,000 (single filers) or $250,000 (married filing jointly).
   (d) Unlike the Social Security tax and the regular Medicare portion, an employer does not match the employees' 0.9% additional Medicare tax.
   (e) An additional 3.8% Medicare tax is assessed on the investment income of individuals whose modified adjusted gross income exceeds $200,000 ($250,000 for married couples).
3. Unemployment Taxes. For 2025, FUTA tax applies at a rate of 6.0% on the first $7,000 of covered wages paid during the year to each employee.
   (a) The Federal government allows a credit for unemployment tax paid to the state. The credit cannot exceed 5.4% of the covered wages.
   (b) FUTA and state unemployment taxes differ from FICA in that the tax is imposed only on the employer.
4. Self-Employment Tax. Self-employed individuals also pay into the FICA system in the form of a self-employment (SE) tax. They are required to pay both the employer and the employee portion of the FICA taxes.
   (a) The 2025 SE tax rate is 15.3% on self-employment income up to $176,100 and 2.9% on all additional self-employment income.

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(b) Self-employed individuals may deduct half of the SE tax—the amount normally deductible by an employer as a business expense.

iv. State Income Taxes. Most states impose a traditional income tax on individuals. New Hampshire imposes an individual income tax only on dividend and interest income. Most states also impose either a corporate income tax or a franchise tax based in part on corporate income.

v. State Franchise Taxes. A franchise tax is a tax on the privilege of doing business in a state or local jurisdiction. The tax is imposed by states on corporations, but the tax base varies from state to state.

vi. Local Income Taxes. The imposition of income taxes by local jurisdictions, though not uncommon, is more the exception than the rule.

vii. Concept Summary 1.1 in the text provides an overview of the major taxes existing in the United States and specifies which political jurisdiction imposes them.

IV. Income Taxation of Business Entities (1.5, PPT Slides 70–80)

a. Proprietorships
   i. The simplest form of business entity is a proprietorship.
   ii. Because a proprietorship is owned by an individual, the individual has great flexibility in structuring the entity's transactions in a way that will minimize their effective income tax rate.

b. C Corporations
   i. Corporations that are separate taxable entities are referred to as C corporations because they are governed by Subchapter C of the Internal Revenue Code. (See Chapters 11 and 12 in the text.)
   ii. While a C corporation pays tax on its income when it is earned, its shareholders then pay income tax on the dividends they receive when the corporation distributes its profits.

c. Partnerships
   i. Though a separately recognized legal entity, a partnership is not a taxpaying entity.
   ii. A partnership files a tax return (Form 1065) on which it summarizes the financial results of the business. Each partner then includes in their own taxable income his or her share of the net income or loss and other special items that were reported on the partnership return. (See Chapter 13 in the text.)

d. S Corporations
   i. Corporations that meet certain requirements may elect to be S corporations, governed by Subchapter S of the Code. (See Chapter 14 in the text.)

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ii. An S corporation is treated like a C corporation for all nontax purposes as both are entities formed under a particular state's corporate law. Regarding tax, however, an S corporation is treated similarly to a partnership.

e. Limited Liability Companies and Limited Liability Partnerships
   i. Limited liability companies (LLCs) and limited liability partnerships (LLPs) offer limited liability and some (but not all) of the other nontax features of corporations.
   ii. Both forms usually are treated as partnerships for tax purposes.
   iii. The S corporation, limited liability company, and partnership forms of organization, which are referred to as flow-through entities, avoid the double taxation problem associated with the C corporation.

f. Dealings Between Individuals and Their Business Entities
   i. Many of the tax issues unique to business entities involve their relations to, and transactions with, their owners. These issues include:
      1. The contribution of assets to the entity by the owner, at the formation of the entity and afterward.
      2. Compensation paid by the entity to its owner or owners for services provided.
      3. The distribution of the entity's profits to its owner or owners.
      4. The owners' disposition of their interest in the entity, during the course of the entity's life or upon its dissolution.
   ii. Every major transaction that occurs between an owner and a business entity has important tax ramifications.

V. Understanding the Federal Tax Law (1.6, PPT Slides 81–86)

   i. The Federal tax law is shaped by all three branches of our Federal government. It is a mixture of laws passed by Congress, explanations provided by the Treasury Department and the Internal Revenue Service (IRS), and interpretations of the law by the courts.

a. Revenue Needs
   i. In an ideal world, taxes raised by the government would equal the expenses incurred by government operations.
   ii. The U.S. Constitution allows deficit spending, and politicians often find it hard to resist the temptation to spend more than the tax system collects currently.

b. Economic Considerations
   i. The tax system is often used to help achieve economic goals. For example, tax rates may be increased or reduced in the hopes of reducing or increasing economic activity generally.
   ii. Encouragement of Certain Activities. Congress often uses the tax law to encourage specific types of economic activity.

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1. To encourage investment in certain business assets, such as equipment, the tax law may allow for extra ("bonus") depreciation in the year of acquisition.
2. Ecological considerations justify a tax provision that permits a more rapid expensing of the costs of installing pollution control facilities or making buildings more energy efficient or tax credits for the production or use of alternative energy.
3. Considering the pressing and continuing problem of a deficit in the U.S. balance of payments, Congress has established incentives for U.S. citizens who accept employment overseas and for business entities that operate in countries outside the United States.
4. Saving can lead to capital formation, making funds available to finance home construction and industrial expansion. The tax law encourages saving by according preferential treatment to private retirement plans.

iii. Encouragement of Certain Industries.

1. The tax law is sometimes used to encourage specific industries. For example, the Federal tax law has long been used to facilitate agriculture. Among the tax benefits are the election to expense rather than capitalize certain soil and water conservation expenditures and fertilizers and the election to defer the recognition of gain on the receipt of crop insurance proceeds.
2. To stimulate research and production of alternative fuel sources, tax incentives are allowed with respect to operations and sales of certain solar and wind energy devices and of autos that do not consume petroleum products.

iv. Encouragement of Small Business. The belief that what is good for small business is good for the economy as a whole has led to special provisions in the tax law that favor small business.

c. Social Considerations

i. Some provisions of the Federal tax law, particularly those dealing with individuals, can be explained by a desire to encourage certain behavior to help address social concerns.

1. Health insurance provided to employees by employers is excluded from an employee's taxable income. Employers are allowed a tax deduction for these payments.
2. Certain income contributed by an employer to a qualified pension or profit sharing plan while the employee is still working is not taxable to the employee until the funds are distributed at retirement. Tax on the income generated by the contributions is also deferred.

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3. A deduction is allowed for contributions to qualified organizations.
4. Various tax incentives are designed to encourage taxpayers to obtain or extend their level of education.
5. A tax credit is allowed for amounts spent to furnish care for certain minor or disabled dependents to enable the taxpayer to seek or maintain gainful employment.
6. Taxpayers are not allowed to reduce their taxable income for certain expenditures deemed to be contrary to public policy (e.g., fines, penalties, illegal kickbacks, bribes to government officials, and gambling losses in excess of gains).

d. Equity Considerations
   i. Though the desire for a fair and equitable tax law is ubiquitous, agreement on what is "fair" can be anything but. Lawmakers and others often consider whether a tax change is progressive or regressive to understand its impact on taxpayers and whether the change should be made.
   ii. If a tax represents the same percentage of the income of all taxpayers, it is a proportional tax.
   iii. The Wherewithal to Pay Concept. The wherewithal to pay concept recognizes the burden of imposing a tax at a time when the taxpayer lacks the means to pay the tax.
      1. The wherewithal to pay concept underlies a provision in the tax law dealing with the treatment of gain resulting from an involuntary conversion.
      2. Gains resulting from involuntary conversions may often be deferred if the property is replaced in a specified period of time.
   iv. Mitigating the Effect of the Annual Accounting Period Concept. The application of this annual accounting period concept can lead to dissimilar tax treatment for taxpayers who are, from a long-range standpoint, in the same economic position.
   v. Coping with Inflation. Because of the progressive nature of the income tax, a wage adjustment to compensate for inflation could place the employee in a higher income tax bracket.
      1. Congress recognizes this problem and adjusts various income tax components, such as tax brackets, standard deduction amounts, and a wide variety of other items, through an indexation procedure.

e. Political Influence
   i. Because the tax law is enacted by elected officials, it is often influenced by political considerations.
   ii. Special Interest Legislation. Certain provisions of the tax law largely can be explained by the political influence some groups have had on Congress.

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iii. State and Local Government Influences. State law has had an influence in shaping our present Federal tax law.
   1. One example of this effect is the evolution of Federal tax law in response to states with community property systems.
   2. The difference between common law and community property systems centers around the property rights held by married persons.
   3. At one time, the tax position of the residents of community property states was so advantageous that many common law states adopted community property systems. Political pressure placed on Congress to correct the disparity in tax treatment was considerable.
   4. Congress changed the law to extend many of the community property tax advantages to residents of common law jurisdictions.
      (a) The law change allowed married taxpayers to file joint returns and compute the tax liability as if one-half of the income had been earned by each spouse.
      (b) The income-splitting benefits of a joint return are incorporated as part of the tax rates applicable to married taxpayers.
   5. A similar motivation can be seen for the gift-splitting provisions of the Federal gift tax and the marital deduction of the Federal estate and gift taxes.

f. Compliance Considerations
   i. A tax system generally includes rules to ensure proper compliance by taxpayers.
      1. Due dates for returns and tax payments.
      2. Procedures for examination (audit) and collection activities of the IRS.
   ii. Numerous penalties also exist in the tax law to encourage proper compliance by taxpayers, as well as by their paid preparers.
      1. Penalties can be assessed on taxpayers for failing to pay their taxes (or failing to pay on time), claiming improper deductions or misstating income, or not having substantial legal authority for claiming a deduction or credit.
      2. Penalties imposed on return preparers include failing to furnish the taxpayer with a copy of the return, failing to sign the return as a preparer, failing to furnish an identification number, and failing to keep copies of returns or maintain a client list.

g. Influence of the Internal Revenue Service (1.7, PPT Slides 87–90)
   i. One of the keys to an effective administration of our tax system is the audit process conducted by the IRS.

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ii. The IRS influences laws by suggesting changes to Congress based on compliance problems it discovers.
iii. The U.S. Treasury Department and the IRS also affect tax laws via the Regulations and rulings they issue that explain and interpret Code provisions.

h. Influence of the Courts
i. In addition to interpreting the tax law passed by Congress and the administrative and interpretive pronouncements issued by the Treasury Department and the IRS, the Federal courts have influenced tax law in two other ways.
1. The courts have developed a number of judicial concepts that help guide the application of various tax provisions, going beyond the strict language of the Code and Treasury Regulations.
2. Certain key court decisions have led to changes in the Code and other sources of tax law.
ii. Judicial Concepts and Doctrines Relating to Tax. In dealings between related parties, the courts test transactions by looking to whether the taxpayers acted in an arm's length manner.
iii. Judicial Influence on Statutory Provisions. Some court decisions have been of such consequence that Congress has incorporated them into statutory tax law.

i. The Increasing Use of Temporary Tax Provisions
i. Most tax laws are effective until lawmakers expressly act to change them. However, lawmakers may sometimes enact tax provisions that are effective only for a limited period of time.
ii. At the end of that period, the provision will expire, or "sunset," and the law will automatically revert back to what it was prior to the provision's enactment.
iii. The Tax Cuts and Jobs Act of 2017 (TCJA) included numerous temporary provisions that will sunset between the end of 2025 and 2028 unless lawmakers act to extend them.
iv. These temporary provisions, as well as others that have been passed previously and will likely be passed in the future, and the uncertainty surrounding their potential extension or expiration, complicate business and investment planning for taxpayers who are unsure about the longer-term tax implications of their activities.

VI. Tax Planning Fundamentals (1.8, PPT Slides 91–97)

a. Overview of Tax Planning and Ethics
i. It is a long-standing principle that taxpayers have no obligation to pay more than their fair share of taxes.
ii. Tax Planning: Avoidance Versus Evasion.

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1. Minimizing taxes legally is referred to as tax avoidance.
2. Tax evasion is attempting to evade income taxes through illegal actions.
3. Clients expect tax professionals to provide advice to help them minimize their tax costs through tax planning.

iii. Tax Practice Ethics. Tax planning (avoidance) is an ethical activity for tax professionals as well as taxpayers.

1. Circular 230. "Regulations Governing Practice before the Internal Revenue Service" issued by the Treasury Department.
   (a) Contain rules of conduct to be allowed to practice before the IRS.
   (b) Administered by the IRS Office of Professional Responsibility (OPR).
   (c) A Circular 230 violation could lead to the loss or suspension of a CPA's license at the state level as well.
2. Statements on Standards for Tax Services. Statements issued by the AICPA and enforceable as part of its Code of Professional Conduct.
   (a) Any tax position taken should be supported by a good-faith belief that it has a realistic possibility of being sustained if challenged.
   (b) Upon learning of an error on a past tax return, advise the client to correct it. Do not inform the IRS of the error.
   (c) Practitioners have a responsibility to protect the security of taxpayer information, including when it is transmitted and how it is stored electronically.
   (d) Practitioners must exercise appropriate professional judgment and care when relying on any type of tool to provide services. These tools may help in performing tax and accounting work, but the ultimate responsibility for preparing a correct tax return or reaching the correct answer using tax research tools rests with the tax practitioner.

b. A General Framework for Income Tax Planning (1.9, PPT Slides 98–105)

i. The primary goal of tax planning is to design a transaction so as to minimize its tax costs while meeting the other nontax objectives of the client.

ii. Careful analysis of the tax formula (refer to Exhibit 1.1 in the text) reveals a series of tax minimization strategies.

iii. The General Framework for Income Tax Planning in Exhibit 1.3 in the text lists each element in the income tax formula, develops tax planning strategies designed to minimize taxes, and provides brief summaries of specific examples of tax planning.

c. Tax Minimization Strategies Related to Income

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i. Avoid income recognition. (See Example 27 in the text.)
ii. Postpone recognition of income to achieve tax deferral. (See Example 28 in the text.)

d. Tax Minimization Strategies Related to Deductions
   i. Maximize deductible amounts. A corporation that owns stock in another corporation is eligible for a dividends received deduction (DRD).
      1. The DRD is equal to a specified percentage of the dividends received. The percentage is based on the amount of stock that the investor corporation owns in the investee corporation.
         - 50% deduction for ownership of less than 20%.
         - 65% deduction for ownership of 20% or more but less than 80%.
         - 100% deduction for ownership of 80% or more.
      2. Example 29 in the text demonstrates the tax advantage of dividend income versus interest income.
   ii. Accelerate recognition of deductions to achieve tax deferral. (See Example 30 in the text.)

e. Tax Minimization Strategies Related to Tax Rates
   i. Shift net income from high-bracket years to low-bracket years. (See Examples 31 and 32 in the text.)
   ii. Shift net income from high-bracket taxpayers to low-bracket taxpayers. (See Example 33 in the text.)
   iii. Shift net income from high-tax jurisdictions to low-tax jurisdictions. (See Examples 34 and 35 in the text.)
   iv. Control the character of income and deductions. (See Example 36 in the text.)
   v. Avoid double taxation.
      1. Shareholders can avoid double taxation by electing that a corporate entity become an S corporation. (See Example 37 in the text.)
      2. Other entity choices can be used to avoid double taxation, including partnerships and limited liability companies.
      3. Choosing to operate as a flow-through entity is not the only way to avoid double taxation. Double taxation can be avoided or minimized by having the corporation make tax-deductible payments, such as salaries, rent, and interest to the shareholders. (See Example 38 in the text.)

f. Tax Minimization Strategies Related to Tax Credits
   i. Maximize tax credits. (See Example 39 in the text.)
      1. A deduction reduces taxable income, which results in a reduction of the tax paid.
      2. A tax credit reduces the tax liability dollar for dollar and is not affected by the taxpayer's tax rate.

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ii. The above strategies can also be organized around four basic tax planning goals: controlling
   1. When: When income and expenses are recognized for tax purposes is largely determined by the tax accounting methods employed. See text Sections 3-3 and 4-2.
   2. What: A taxpayer's tax liability can be reduced by changing the character/nature of the income and expenses recognized. See Chapters 3, 4, 9, and 16 in the text.
   3. Who: Tax liabilities can be reduced by shifting the taxation of income from a taxpayer with a relatively higher marginal rate to one with a relatively lower rate. See text Section 8-5d and Chapters 11 through 14 in the text.
   4. Where: Tax liabilities may be reduced by shifting the taxation of income from a jurisdiction with a relatively higher marginal rate to one with a relatively lower rate. See Chapter 17 in the text.

VII. Summary

i. Tax professionals must be adept in various skills to deliver expected levels of service to clients and the government:
   - Knowledge of technical tax law.
   - Productive with technology and data analytics.
   - Strengths in business acumen and so-called soft skills, like listening and motivation.
   - Functional in problem solving and process improvement.
   - Valued contributor in project management and cost-benefit analysis.
   - Excellent verbal and written communication skills.

ii. Tax planning is a means by which to manage the amount and timing of tax liabilities to accomplish one's long-term objectives.

iii. The conduct of tax practitioners is regulated by state licensing bodies (for CPAs and attorneys primarily), professional associations, penalties that can apply to practitioners and their clients, and taxing agencies.

iv. In addition to its necessary revenue-raising objective, the Federal tax law has developed in response to several other factors:
   1. Economic considerations. Tax provisions can help to regulate the economy and encourage certain activities and types of businesses.
   2. Social considerations. Some tax provisions are designed to encourage (or discourage) socially desirable (or undesirable) practices.
   3. Equity considerations. Tax provisions can alleviate the effect of multiple taxation, recognize the wherewithal to pay concept,

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and mitigate the effect of the annual accounting period concept.

4. Compliance considerations. Tax rules provide for examinations, penalties, and interest to help ensure proper compliance (timely filing of returns and payment of taxes) by taxpayers.
5. Political influence. Tax provisions can carry out the desires of special interest groups or reflect the effect of state and local law.
6. Influence of the IRS. Many tax provisions are intended to aid the IRS in the collection of revenue and the administration of the tax law.
7. Influence of the courts. Court decisions have established a body of judicial concepts relating to tax law and have, on occasion, led Congress to enact statutory provisions to either clarify or negate their effect.

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Discussion Questions

You can assign these questions several ways: in a discussion forum in your LMS; as whole-class discussions in person; or as a partner or group activity in class.

1. Discussion 1 (1.3 and 1.9, PPT Slides 24–49 and 98–105) Duration 15 minutes.
    a. James Corporation believes it will be able to more efficiently distribute its products if it relocates the corporation to another state. What considerations (both tax and nontax) should James weigh before making a decision on whether to make the move?
        i. Answer: Some tax and nontax considerations James should investigate include the following:
            - State and local income taxes.
            - State and local sales taxes.
            - State and local property taxes.
            - Employee implications of the move. (Will James lose current employees? Is the labor market better in the new location? Is the cost of living lower or higher in the new location?)
            - Logistics/transportation of products to customers (specifically document lower costs).
            - State infrastructure (better in new location?).

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2. Discussion 2 (1.3, PPT Slides 24–49) Duration 15 minutes.
    a. The Adams Independent School District wants to sell a parcel of unimproved land that it does not need. Its three best offers are as follows: from the State Department of Public Safety (DPS), $2,300,000; from Second Baptist Church, $2,200,000; and from Baker Motors, $2,100,000. DPS would use the property for a new state highway patrol barracks, Second Baptist would start a church school, and Baker would open a car dealership. As the financial adviser for the school district, which offer would you prefer? Why?
        i. Answer: Although the Baker Motors bid is the lowest, from a long-term financial standpoint, it is the best. The proposed use of the property by the state and the church probably will make it exempt from the school district's ad valorem tax. This would hardly be the case with a car dealership. In fact, commercial properties (e.g., car dealerships) often are subject to higher tax rates.

3. Discussion 3 (1.3, PPT Slides 24–49) Duration 15 minutes.
    a. Franklin County is in dire financial straits and is considering a number of sources for additional revenue. Evaluate the following possibilities in terms of anticipated taxpayer compliance:
        1. A property tax on business inventories.
        2. A tax on intangibles (i.e., stocks and bonds) held as investments.
        3. A property tax on boats used for recreational purposes.
            i. Answer: Additional pertinent tax issues include the following:
                1. In terms of taxpayer compliance, an ad valorem tax on personalty is less desirable than one on realty. However, a tax on business personalty, such as inventory, is to be preferred over one on personal use (i.e., nonbusiness) personalty.
                2. A tax on stocks and bonds would be too easily avoided. The taxing authority would have no means of ascertaining ownership of these assets.
                3. Poor taxpayer compliance is to be expected for any tax on personal use personalty. However, if boats had to be periodically licensed (e.g., safety inspection), this could provide the taxing authority with a means of discovering unreported boat ownership.

4. Discussion 4 (1.3, 1.4, and 1.8, PPT Slides 24–69 and 91–97) Duration 15 minutes.
    a. Mike Barr was an outstanding football player in college and expects to be drafted by the NFL in the first few rounds. Mike has let it be known that he would prefer to sign with an NFL team located in Florida, Texas, or Washington. Is Mike undertaking good income tax planning? Explain.

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i. Answer: If Mike is drafted by a team in one of the listed states, he will escape state income tax on income earned within that state (e.g., training camp, home games). He will not, however, escape the income tax (state and local) imposed by jurisdictions where he plays away games. Called the "jock tax," it is applied to out-of-state athletes and entertainers.

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