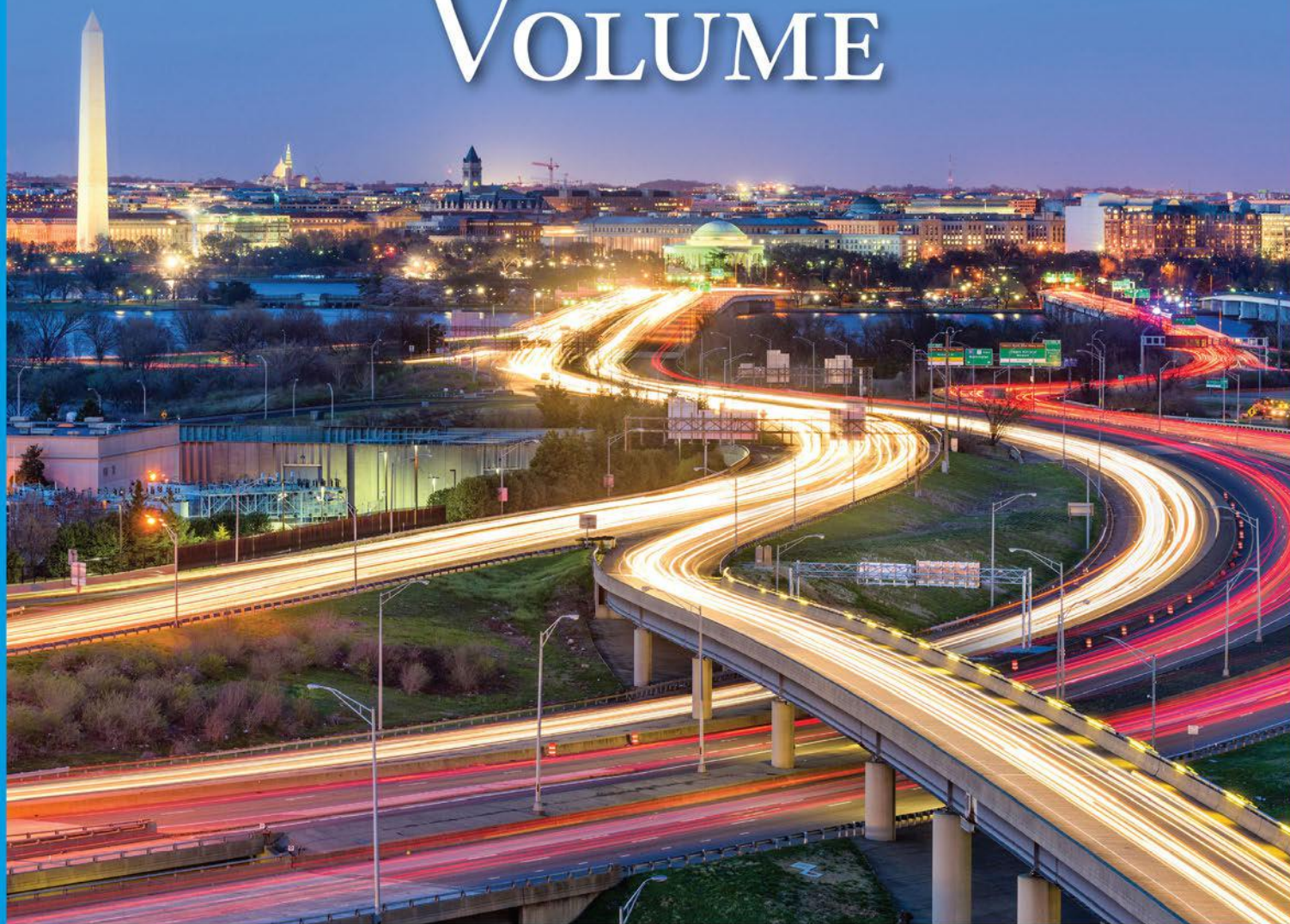




CENGAGE

**SOUTH-WESTERN**  
FEDERAL TAXATION

# COMPREHENSIVE VOLUME



**INCLUDED:**



the answer company™  
**THOMSON REUTERS®**

**ProConnect™ Tax**

**Becker+**

Young • Maloney  
Nellen • Persellin  
Cuccia

2022

## 2020 Tax Rate Schedules

Single—Schedule X				Head of household—Schedule Z			
If taxable income is: Over—	But not over—	The tax is:	of the amount over—	If taxable income is: Over—	But not over—	The tax is:	of the amount over—
\$ 0	\$ 9,875	.....10%	\$ 0	\$ 0	\$ 14,100	.....10%	\$ 0
9,875	40,125	\$ 987.50 + 12%	9,875	14,100	53,700	\$ 1,410.00 + 12%	14,100
40,125	85,525	4,617.50 + 22%	40,125	53,700	85,500	6,162.00 + 22%	53,700
85,525	163,300	14,605.50 + 24%	85,525	85,500	163,300	13,158.00 + 24%	85,500
163,300	207,350	33,271.50 + 32%	163,300	163,300	207,350	31,830.00 + 32%	163,300
207,350	518,400	47,367.50 + 35%	207,350	207,350	518,400	45,926.00 + 35%	207,350
518,400	.....	156,235.00 + 37%	518,400	518,400	.....	154,793.50 + 37%	518,400
Married filing jointly or Qualifying widow(er)—Schedule Y–1				Married filing separately—Schedule Y–2			
If taxable income is: Over—	But not over—	The tax is:	of the amount over—	If taxable income is: Over—	But not over—	The tax is:	of the amount over—
\$ 0	\$ 19,750	.....10%	\$ 0	\$ 0	\$ 9,875	.....10%	\$ 0
19,750	80,250	\$ 1,975.00 + 12%	19,750	9,875	40,125	\$ 987.50 + 12%	9,875
80,250	171,050	9,235.00 + 22%	80,250	40,125	85,525	4,617.50 + 22%	40,125
171,050	326,600	29,211.00 + 24%	171,050	85,525	163,300	14,605.50 + 24%	85,525
326,600	414,700	66,543.00 + 32%	326,600	163,300	207,350	33,271.50 + 32%	163,300
414,700	622,050	94,735.00 + 35%	414,700	207,350	311,025	47,367.50 + 35%	207,350
622,050	.....	167,307.50 + 37%	622,050	311,025	.....	83,653.75 + 37%	311,025

## 2021 Tax Rate Schedules

Single—Schedule X				Head of household—Schedule Z			
If taxable income is: Over—	But not over—	The tax is:	of the amount over—	If taxable income is: Over—	But not over—	The tax is:	of the amount over—
\$ 0	\$ 9,950	.....10%	\$ 0	\$ 0	\$ 14,200	.....10%	\$ 0
9,950	40,525	\$ 995.00 + 12%	9,950	14,200	54,200	\$ 1,420.00 + 12%	14,200
40,525	86,375	4,664.00 + 22%	40,525	54,200	86,350	6,220.00 + 22%	54,200
86,375	164,925	14,751.00 + 24%	86,375	86,350	164,900	13,293.00 + 24%	86,350
164,925	209,425	33,603.00 + 32%	164,925	164,900	209,400	32,145.00 + 32%	164,900
209,425	523,600	47,843.00 + 35%	209,425	209,400	523,600	46,385.00 + 35%	209,400
523,600	.....	157,804.25 + 37%	523,600	523,600	.....	156,355.00 + 37%	523,600
Married filing jointly or Qualifying widow(er)—Schedule Y–1				Married filing separately—Schedule Y–2			
If taxable income is: Over—	But not over—	The tax is:	of the amount over—	If taxable income is: Over—	But not over—	The tax is:	of the amount over—
\$ 0	\$ 19,900	.....10%	\$ 0	\$ 0	\$ 9,950	.....10%	\$ 0
19,900	81,050	\$ 1,990.00 + 12%	19,900	9,950	40,525	\$ 995.00 + 12%	9,950
81,050	172,750	9,328.00 + 22%	81,050	40,525	86,375	4,664.00 + 22%	40,525
172,750	329,850	29,502.00 + 24%	172,750	86,375	164,925	14,751.00 + 24%	86,375
329,850	418,850	67,206.00 + 32%	329,850	164,925	209,425	33,603.00 + 32%	164,925
418,850	628,300	95,686.00 + 35%	418,850	209,425	314,150	47,843.00 + 35%	209,425
628,300	.....	168,993.50 + 37%	628,300	314,150	.....	84,496.75 + 37%	314,150

## Tax Formula for Individuals

Income (broadly defined).....	\$xx,xxx
Less: Exclusions.....	(x,xxx)
Gross income.....	\$xx,xxx
Less: Deductions <i>for</i> adjusted gross income.....	(x,xxx)
Adjusted gross income.....	\$xx,xxx
Less: The greater of—	
Total itemized deductions	
or standard deduction.....	(x,xxx)
Less: Personal and dependency exemptions*.....	(x,xxx)
Deduction for qualified business income**.....	(x,xxx)
Taxable income.....	<u>\$xx,xxx</u>
Tax on taxable income.....	\$ x,xxx
Less: Tax credits (including Federal income tax	
withheld and prepaid).....	(xxx)
Tax due (or refund).....	<u>\$ xxx</u>

\*Exemption deductions are not allowed from 2018 through 2025.

\*\*Only applies from 2018 through 2025.

**Note:** For 2021, individuals using the standard deduction may also subtract *from* adjusted gross income, cash charitable contributions of up to \$300 (\$600 if married, filing jointly).

## Basic Standard Deduction Amounts

Filing Status	2020	2021
Single	\$12,400	\$12,550
Married, filing jointly	24,800	25,100
Surviving spouse	24,800	25,100
Head of household	18,650	18,800
Married, filing separately	12,400	12,550

## Amount of Each Additional Standard Deduction

Filing Status	2020	2021
Single	\$1,650	\$1,700
Married, filing jointly	1,300	1,350
Surviving spouse	1,300	1,350
Head of household	1,650	1,700
Married, filing separately	1,300	1,350

## Personal and Dependency Exemption

2020	2021
\$4,300	\$4,300

**Note:** Exemption deductions have been suspended from 2018 through 2025. However, the personal and dependency exemption amount is used for other purposes (including determining whether a “qualifying relative” is a taxpayer’s dependent).



# IT'S NOT JUST AN EXAM, IT'S YOUR FUTURE +

## A legacy of learning for a lifetime of success

As the industry's leading partner in CPA Exam preparation, we work harder (and smarter) to help you prepare the way that works best for you. Becker CPA Exam Review is as close as you can get to the real thing. It follows the AICPA blueprint and includes a user-interface that mirrors the exam, so you're already familiar come exam day.

## Personalized learning

No two people learn exactly the same way. That's why our proprietary **Adapt2U Technology** makes learning more personal – and more dynamic. Powered by Sana Labs' award-winning artificial intelligence, it constantly assesses your knowledge as you study and uses this information to provide you with Personalized Review Sessions at the end of each unit.

**1 million +**  
candidates have  
prepared with Becker

**90% +**  
of Watt Sells award  
winners (2005-2019)  
have prepared  
with Becker

**The top 100**  
accounting firms  
rely on Becker for  
their staff's exam  
preparation

**2,900 +**  
accounting firms,  
corporations, alliances,  
government agencies  
and universities  
choose Becker

GET STARTED AT [BECKER.COM](https://www.becker.com)

**Becker**™  
+

Copyright 2022 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. WCN 02-200-322

Copyright 2022 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.



## Make a better grade with CNowv2

Here's how to make every study moment count

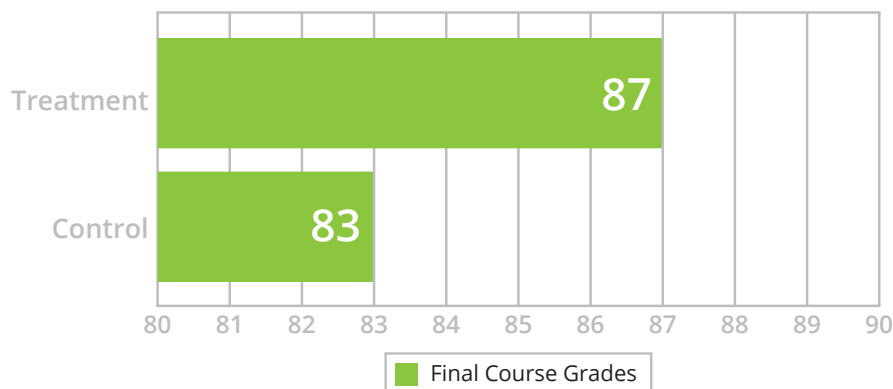
**Multi-media study-tools** such as videos, games, flashcards, crossword puzzles and more allow you to review and check your understanding of key concepts to help you prepare for quizzes and exams.

**The MindTap Reader** is fully optimized for the iPad, provides note-taking and highlighting capabilities and features an online text-to-speech application that vocalizes the content—offering a fun reading experience.

**Flashcards**—use the *MindTap Reader's* pre-made flashcards or make your own. Then print the cards and get to work.

### CNowv2 Users Achieve Higher Grades

(Student Grades, Scale = 0-100; N=246)



Ask your instructor about CNowv2 for this course.  
[cengage.com/cnowv2](https://cengage.com/cnowv2)



"I love the check your work option. Really, when you're having a hard time figuring out an answer, sometimes working backwards is the best way to understand conceptually what you're doing wrong."

**Brad Duncan**

University of Utah



"[I liked]...the read-a-loud option with the ebook... This helped when first starting a chapter and then when studying for tests."

**Jennifer Loughren**

Student,  
Northeast Iowa  
Community College

## AMT Formula for Individuals

---

Taxable income (increased by any standard deduction taken)

**Plus or minus:** Adjustments

**Plus:** Preferences

**Equals:** Alternative minimum taxable income (AMTI)

**Minus:** Exemption

**Equals:** Alternative minimum tax (AMT) base

**Multiplied by:** 26% or 28% rates

**Equals:** Tentative minimum tax before foreign tax credit

**Minus:** AMT foreign tax credit

**Equals:** Tentative minimum tax (TMT)

**Minus:** Regular tax liability (less any foreign tax credit)

**Equals:** AMT (if TMT > regular tax liability)

---

## Income Tax Rates—Estates and Trusts

### Tax Year 2021

Taxable Income		The Tax Is:	
Over—	But not Over—		Of the Amount Over—
\$ 0	\$ 2,650	10%	\$ 0
2,650	9,550	\$ 265.00 + 24%	2,650
9,550	13,050	1,921.00 + 35%	9,550
13,050	.....	3,146.00 + 37%	13,050

## Income Tax Rates—C Corporations, 2018 and after

For all income levels, the tax rate is 21%.

## Unified Transfer Tax Rates

### For Gifts Made and for Deaths after 2012

If the Amount with Respect to Which the Tentative Tax to Be Computed Is:	The Tentative Tax Is:
Not over \$10,000	18 percent of such amount.
Over \$10,000 but not over \$20,000	\$1,800, plus 20 percent of the excess of such amount over \$10,000.
Over \$20,000 but not over \$40,000	\$3,800, plus 22 percent of the excess of such amount over \$20,000.
Over \$40,000 but not over \$60,000	\$8,200, plus 24 percent of the excess of such amount over \$40,000.
Over \$60,000 but not over \$80,000	\$13,000, plus 26 percent of the excess of such amount over \$60,000.
Over \$80,000 but not over \$100,000	\$18,200, plus 28 percent of the excess of such amount over \$80,000.
Over \$100,000 but not over \$150,000	\$23,800, plus 30 percent of the excess of such amount over \$100,000.
Over \$150,000 but not over \$250,000	\$38,800, plus 32 percent of the excess of such amount over \$150,000.
Over \$250,000 but not over \$500,000	\$70,800, plus 34 percent of the excess of such amount over \$250,000.
Over \$500,000 but not over \$750,000	\$155,800, plus 37 percent of the excess of such amount over \$500,000.
Over \$750,000 but not over \$1,000,000	\$248,300, plus 39 percent of the excess of such amount over \$750,000.
Over \$1,000,000	\$345,800, plus 40 percent of the excess of such amount over \$1,000,000.



# SOUTH-WESTERN FEDERAL TAXATION

# COMPREHENSIVE VOLUME

# 2022

## General Editors

**James C. Young**  
Ph.D., CPA

**David M. Maloney**  
Ph.D., CPA

**Annette Nellen**  
J.D., CPA, CGMA

**Mark B. Persellin**  
Ph.D., CPA, CFP®

**Andrew D. Cuccia**  
Ph.D., CPA

## Contributing Authors

**James H. Boyd**  
Ph.D., CPA  
Arizona State University

**Bradrick M. Cripe**  
Ph.D., CPA  
Northern Illinois University

**D. Larry Crumbley**  
Ph.D., CPA  
Texas A&M University -  
Corpus Christi

**Andrew D. Cuccia**  
Ph.D., CPA  
University of Oklahoma

**Steven C. Dilley**  
J.D., Ph.D., CPA  
Michigan State University

**William H. Hoffman, Jr.**  
J.D., Ph.D., CPA  
University of Houston

**Sharon S. Lassar**  
Ph.D., CPA  
University of Denver

**David M. Maloney**  
Ph.D., CPA  
University of Virginia

**Annette Nellen**  
J.D., CPA, CGMA  
San Jose State University

**Mark B. Persellin**  
Ph.D., CPA, CFP®  
St. Mary's University

**William A. Raabe**  
Ph.D., CPA  
Madison, Wisconsin

**Toby Stock**  
Ph.D., CPA  
Ohio University

**James C. Young**  
Ph.D., CPA  
Northern Illinois University

**Kristina Zvinakis**  
Ph.D.  
The University of Texas  
at Austin



Australia • Brazil • Canada • Mexico • Singapore • United Kingdom • United States

Copyright 2022 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. WCN 02-200-322

Copyright 2022 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.



This is an electronic version of the print textbook. Due to electronic rights restrictions, some third party content may be suppressed. Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. The publisher reserves the right to remove content from this title at any time if subsequent rights restrictions require it. For valuable information on pricing, previous editions, changes to current editions, and alternate formats, please visit [www.cengage.com/highered](http://www.cengage.com/highered) to search by ISBN#, author, title, or keyword for materials in your areas of interest.

Important Notice: Media content referenced within the product description or the product text may not be available in the eBook version.

**South-Western Federal Taxation:  
Comprehensive Volume, 2022 Edition**

**James C. Young, David M. Maloney,  
Annette Nellen, Mark B. Persellin,  
Andrew D. Cuccia**

SVP, Higher Education & Skills Product: Erin Joyner

VP, Higher Education & Skills Product: Mike Schenk

Product Director: Jason Fremder

Assoc. Product Manager: Jonathan Gross

Learning Designer: Emily S. Lehmann

Sr. Content Manager: Nadia Saloom

Sr. Digital Delivery Lead: Tim Richison

IP Analyst: Ashley Maynard

IP Project Manager: Kumaresan  
Chandrakumar, Integra

Marketing Manager: Chris Walz

Marketing Coordinator: Sean D. Messer

Production Service: SPi Global

Designer: Chris A. Doughman

Text Designer: Red Hangar Design

Cover Designer: Bethany Bourgeois

Cover Image: iStock.com/Sean Pavone

**Design Images:**

Concept Summary:

iStock.com/enot poloskun

Global Tax Issues: enot-poloskun/

E+/Getty Images

Ethics & Equity: iStock.com/LdF

Cumulative Problems/Tax Return Problems:

iStock.com/peepo

Financial Disclosure Insights: Vyaseleva

Elena/Shutterstock.com

Framework 1040: Concept Photo/

Shutterstock.com

© 2022, 2021 Cengage Learning, Inc.

Unless otherwise noted, all content is © Cengage.

ALL RIGHTS RESERVED. No part of this work covered by the copyright herein may be reproduced or distributed in any form or by any means, except as permitted by U.S. copyright law, without the prior written permission of the copyright owner.

For product information and technology assistance, contact us at  
**Cengage Customer & Sales Support, 1-800-354-9706 or  
support.cengage.com.**

For permission to use material from this text or product,  
submit all requests online at **www.cengage.com/permissions.**

All tax forms within the text are: Source: Internal Revenue Service

Tax software: Source: Intuit ProConnect Tax

Becker CPA Review: Source: Becker CPA

Excel screenshots: Source: Used with permissions from Microsoft  
Intuit ProConnect Tax, Becker, Microsoft and Checkpoint and all Intuit  
ProConnect Tax, Becker, Microsoft and Checkpoint-based trademarks and  
logos are registered trademarks of Intuit ProConnect Tax, Becker, Microsoft  
and Checkpoint in the United States and other countries.

ISSN: 0741-5184

2022 Annual Edition

Student Edition with Intuit ProConnect Tax + RIA Checkpoint

ISBN: 978-0-357-51101-5

Loose Leaf Edition with Intuit ProConnect Tax + RIA Checkpoint

ISBN: 978-0-357-51103-9

**Cengage**

200 Pier 4 Boulevard

Boston, MA 02210

USA

Cengage is a leading provider of customized learning solutions with  
employees residing in nearly 40 different countries and sales in more than  
125 countries around the world. Find your local representative at  
**www.cengage.com.**

To learn more about Cengage platforms and services, register or access  
your online learning solution, or purchase materials for your course, visit  
**www.cengage.com.**

Printed in the United States of America  
Print Number: 01      Print Year: 2021

# ProConnect™ Tax

intuit®  
Accountants

## Work like a pro.

Get the #1 cloud-based professional tax software for free.<sup>1, 2</sup>

Go beyond the basics and connect with the modern tools you need to work efficiently.

- **Work with confidence.**

Get returns done right the first time with access to all the forms you need, backed by industry-leading calculations and diagnostics.

- **Work smarter.**

Save time with logical data-entry worksheets instead of traditional forms-based methods. Plus, get quick training resources so it's easy to stay up to speed.

- **Work from anywhere.**

It's all online, so there's nothing to install or maintain. And whether you're on your mobile phone or laptop, PC or Mac – you're always good to go.

Visit [TaxEducation.Intuit.com](https://TaxEducation.Intuit.com) to get started.

*Only one sign-up per student. No special code required. If you have trouble accessing or using the software, reach out to us at [taxeducation\\_support@intuit.com](mailto:taxeducation_support@intuit.com) anytime for help.*

<sup>1</sup> Based on Intuit internal data of the number of paid users of ProConnect Tax for Tax Year 2019 compared to publicly available statements from competitors for the same time period.

<sup>2</sup> If you sign-up for the free version of ProConnect Tax for students and educators, you will not have access to certain features, including functionality such as Electronic Filing Services and Intuit Link.

THOMSON REUTERS

# CHECKPOINT

## 3 Simple Ways Checkpoint Helps You Make Sense of All Those Taxes

- 1 Find what you are looking for quickly and easily online with Checkpoint®
- 2 A comprehensive collection of primary tax law, cases and rulings, along with analytical insight you simply can't find anywhere else
- 3 Checkpoint has built-in productivity tools to make research more efficient — a resource more tax pros use than any other

### Titles that include Checkpoint Student Edition:

- Young/Nellen/Raabe/Persellin/Hoffman, *South-Western Federal Taxation: Individual Income Taxes, 2022 Edition*
- Raabe/Young/Nellen/Hoffman, *South-Western Federal Taxation: Corporations, Partnerships, Estates & Trusts, 2022 Edition*
- Young/Maloney/Nellen/Persellin/Cuccia, *South-Western Federal Taxation: Comprehensive Volume, 2022 Edition*
- Nellen/Cuccia/Persellin/Young, *South-Western Federal Taxation: Essentials of Taxation: Individuals and Business Entities, 2022 Edition*
- Murphy/Higgins/Skalberg, *Concepts in Federal Taxation, 2022 Edition*

### Important Information

The purchase of this textbook includes access to Checkpoint Student Edition for a 6-month duration.

To log in, visit **checkpoint.tr.com**, and you will be asked to supply a User ID and Password.

**Instructors:** Please contact your Cengage Account Executive to obtain access for your class.

**Students:** Please work with your instructors to gain access.



**CPA Practice Advisor Rated 5 out of 5 stars**  
**16 consecutive years: 2004-2020**

For technical support, please visit **cengage.com/support**

ISBN-13: 978-0-357-51111-4 • ISBN-10: 0-357-51111-5





# Preface

## COMMITTED TO EDUCATIONAL SUCCESS

**S**outh-Western Federal Taxation (SWFT) is the most trusted and best-selling series in college taxation. We are focused exclusively on providing the most useful, comprehensive, and up-to-date tax texts, online study aids, tax preparation tools, and research tools to help instructors and students succeed in their tax courses and beyond.

SWFT is a comprehensive package of teaching and learning materials, significantly enhanced with each edition to meet instructor and student needs and to add overall value to learning taxation.

The *SWFT Comprehensive Volume*, 2022 Edition provides a dynamic learning experience inside and outside of the classroom. Built with the most important and relevant resources and tools, our complete learning system provides multiple options for students to achieve success.

In addition, the *SWFT Comprehensive Volume*, 2022 Edition provides accessible, comprehensive, and authoritative coverage of the relevant tax code and regulations as they pertain to the individual and business taxpayer, as well as coverage of all major developments in Federal income taxation.

### In revising the 2022 Edition, we focused on:

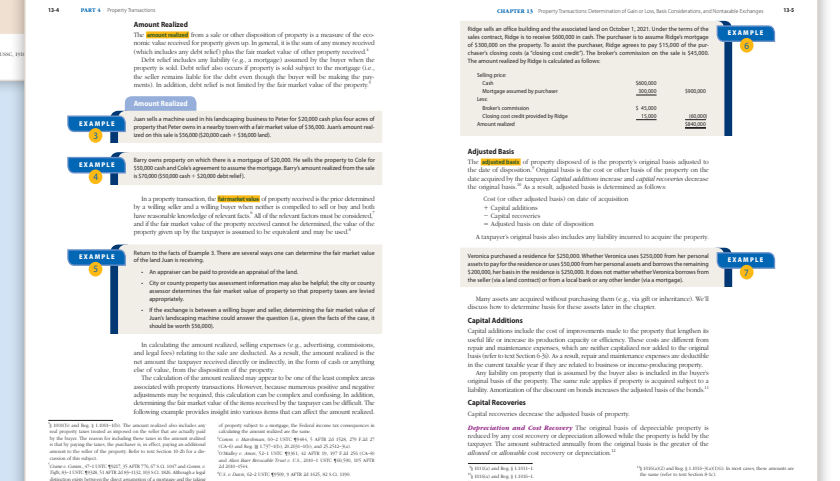
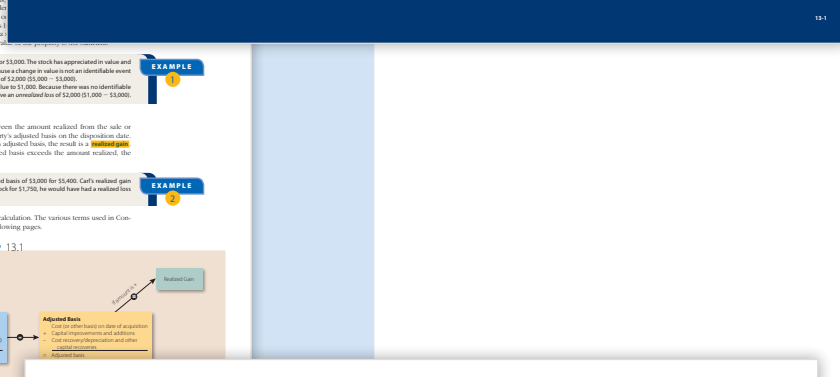
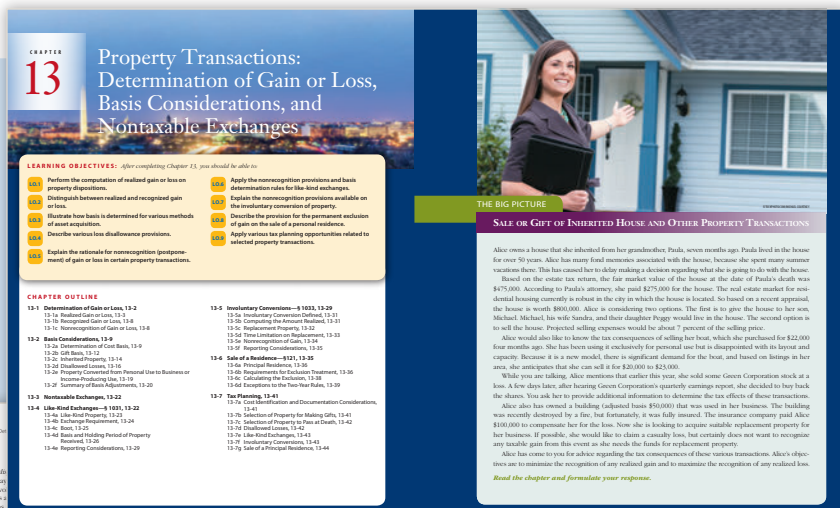
- **Accessibility. Clarity. Substance.** The authors and editors made this their focus as they revised the 2022 edition. Coverage has been streamlined to make it more accessible to students, and difficult concepts have been clarified, all without losing the substance that makes up the *South-Western Federal Taxation* series.
- **Developing professional skills.** SWFT excels in bringing students to a professional level in their tax knowledge and skills, to prepare them for immediate success in their careers. We include development of written and verbal communication skills, the use of tax preparation and tax research software, orientation toward success on the CPA Exam, exposure to tax policy and tax law development, consideration of the time value of money in the tax planning process, and experience with advanced spreadsheet applications and data analytics.
- **CengageNOWv2 as a complete learning system.** Cengage Learning understands that digital learning solutions are central to the classroom. Through sustained research, we continually refine our learning solutions in CengageNOWv2 to meet evolving student and instructor needs. CengageNOWv2 fulfills learning and course management needs by offering a personalized study plan, video lectures, auto-graded homework, auto-graded tests, and a full eBook with features and advantages that address common challenges.



# Learning Tools and Features to Help Students Make the Connection

**FULL-COLOR DESIGN:** We understand that students struggle with learning difficult tax law concepts and applying them to real-world scenarios. The 2022 edition uses color to bring the text to life, capture student attention, and present the tax law in an understandable and logical format.

- Selected content is streamlined to guide students in focusing on the most important rules and concepts for the CPA Exam while still providing in-depth coverage of topics.



- Examples are clearly labeled and directly follow concepts to assist with student application. An average of over 40 examples in each chapter use realistic situations to illustrate the complexities of the tax law and allow students to integrate chapter concepts with illustrations and examples.

**COMPUTATIONAL EXERCISES:** Students need to learn to apply the rules and concepts covered in each chapter to truly understand them. These exercises, many of which mirror text examples, allow students to practice and apply what they are learning.

- ❑ Found in the end-of-chapter sections of the textbook
- ❑ CengageNOWv2 provides algorithmic versions of these problems

26. **LO.1** Melba purchases land from Adrian. Melba gives Adrian \$225,000 in cash and agrees to pay Adrian an additional \$400,000 one year later plus interest at 5%.
- What is Melba's adjusted basis for the land at the acquisition date?
  - What is Melba's adjusted basis for the land one year later?
27. **LO.1** On July 1, 2021, Katrina purchased tax-exempt bonds (face value of \$75,000) for \$82,000. The bonds mature in five years, and the annual interest rate is 3%.
- How much interest income and/or interest expense must Katrina report in 2021, assuming that straight-line amortization is appropriate?
  - What is Katrina's adjusted basis for the bonds on January 1, 2022?

## RESEARCH AND DATA ANALYTICS PROBLEMS:

- ❑ Research Problems provide students with vital practice in an increasingly demanded skill area. Some of these end-of-chapter items ask students to analyze tax data, helping them to understand the application of this information in various scenarios. These essential features prepare students for professional tax environments.

**BECKER PROFESSIONAL EDUCATION REVIEW QUESTIONS:** End-of-chapter CPA Review Questions from Becker PREPARE STUDENTS FOR SUCCESS. Students review key concepts using proven questions from Becker Professional Education®—one of the industry's most effective tools to prepare for the CPA Exam.

- ❑ Located in select end-of-chapter sections
- ❑ Tagged by concept in CengageNOWv2
- ❑ Questions similar to what students would actually find on the CPA Exam

### Becker CPA Review Questions

1. Jasmin purchased 100 shares of Pinkstey Corporation (publicly traded company) on January 1 of year 1 for \$5,000. The FMV of the shares at the end of year 1 was \$6,000. On January 1 of year 4, Pinkstey Corporation declared a 2-for-1 stock split when the fair market value of the stock was \$65 per share. On January 1 of year 5, Jasmin sold all of her Pinkstey Corporation stock when the fair market value was \$40 per share. Which of the following statements is true?
- Jasmin reports \$6,500 in gross income for the 2-for-1 stock split in year 4.
  - Jasmin's basis in the Pinkstey Corporation stock at the end of year 4 is \$65 per share.
  - Jasmin has no taxable income for the Pinkstey Corporation stock in year 4.
  - Jasmin owns 100 shares in Pinkstey Corporation stock at the end of year 4.

**Becker**+

**Becker**+

## See how the SWFT series helps students understand the big picture and the relevancy behind what they are learning.



**THE BIG PICTURE: Tax Solutions for the Real World.** Taxation comes alive at the start of each chapter as The Big Picture examples provide a glimpse into the lives, families, careers, and tax situations of typical filers. Students will follow a family, individual, or other taxpayer throughout the chapter, to discover how the concepts they are learning apply in the real world.

Finally, to solidify student comprehension, each chapter concludes with a **Refocus on the Big Picture** summary and tax planning scenario. These scenarios re-emphasize the concepts and topics from the chapter and allow students to confirm their understanding of the material.

### FRAMEWORK 1040:

#### Fitting It All Together.

This chapter-opening feature demonstrates how individual income tax topics fit together, using the Income Tax Formula for Individuals as the framework. The framework helps students organize their understanding of the chapters and topics to see how they relate to the basic tax formula and then identify where these items are reported on Form 1040. Framework 1040 helps students navigate topics by explaining how tax concepts are organized.

Use this chapter-opening Framework 1040, which shows the topics as they appear in the individual tax formula, to understand where on Form 1040 these chapter topics appear.

## FINANCIAL DISCLOSURE

**INSIGHTS:** Tax professionals need to understand how taxes affect the financial statements. **Financial Disclosure Insights**, appearing throughout the text, use current information about existing taxpayers to highlight book-tax reporting differences, effective tax rates, and trends in reporting conventions.



### FINANCIAL DISCLOSURE INSIGHTS Tax and Book Depreciation

A common book-tax difference relates to the depreciation amounts that are reported for GAAP and Federal income tax purposes. Typically, tax depreciation deductions are accelerated; that is, they are claimed in earlier reporting periods than is the case for financial accounting purposes.

Almost every tax law change since 1980 has included depreciation provisions that accelerate the related deductions relative to the expenses allowed under GAAP. Accelerated cost

recovery deductions represent a means by which the taxing jurisdiction infuses the business with cash flow created by the reduction in the year's tax liabilities.

For instance, recently, about one-quarter of General Electric's deferred tax liabilities related to depreciation differences. Ford's depreciation differences amounted to about one-third of its deferred tax liabilities. And for the trucking firm Ryder Systems, depreciation differences accounted for virtually all of the deferred tax liabilities.



### ETHICS & EQUITY Punching the Time Clock at Year-End

As the end of the tax year approaches, Julie, a successful full-time real estate developer and investor, recognizes that her income tax situation for the year could be bleak. Unless she and her spouse, Ralph, are able to generate more hours of participation in one of her real estate rental activities, they will not reach the material participation threshold. Consequently, the tax losses from the venture will not be deductible. To ensure deductibility, Julie suggests the following plan:

- She will document the time she spends "thinking" about her rental activities.
- During the week, Ralph will visit the apartment building to oversee (in a management role) the operations of the rentals.

- On weekends, she and Ralph will visit the same units to further evaluate the operations.
- Also on the weekends, while they are doing their routine household shopping, they will be on the lookout for other rental properties to buy. Julie plans to count both her and Ralph's weekend hours toward the tally of total participation.

Julie contends that the law clearly allows the efforts of one's spouse to count for purposes of the material participation tests. Likewise, nothing in the tax law requires taxpayers to be efficient in their hours of participation. How do you react?

**ETHICS & EQUITY:** Many tax issues do not have just one correct answer.

**Ethics & Equity** features will spark critical thinking and invite classroom discussion, enticing students to evaluate their own value system. Suggested answers to Ethics & Equity scenarios appear in the Solutions Manual.

**TAX PLANNING:** Chapters include a separate section calling attention to how taxpayers can use the law to reach financial and other goals. Tax planning applications and suggestions appear throughout each chapter.

## 27-5 TAX PLANNING

### 27-5a The Federal Gift Tax

For gifts that generate a tax, consideration must be given to the present value to the donor of the gift taxes paid. Because the donor loses the use of these funds, the expected interval between a gift (the imposition of the gift tax) and death (the imposition of the estate tax) may make the gift less attractive from an economic standpoint. On the plus side, however, are the estate tax savings that result from any gift tax paid. Because these funds are no longer in the gross estate of the donor (except for certain gifts within three years of death), the estate tax thereon is avoided.



### GLOBAL TAX ISSUES Tracking Down Tax Dollars

Non-U.S. persons who earn income within the United States may need to file a Federal income tax return, but they may not have a Social Security number for filing purposes. If not, they can use a nine-digit Individual Tax Identification Number (ITIN) instead. The IRS issues ITINs upon the submission of an application and proof of identification (e.g., a driver's license). As the IRS does not require an applicant to show that he or she is in the United States legally, the ITINs are freely available to undocumented persons (i.e., illegal immigrants). The use of an ITIN also can enable the holder to carry out other financial transactions (e.g., establish a bank account, secure a credit card, and obtain a loan).

The position of the IRS is that the current ITIN procedure brings in revenue that otherwise would not be forthcoming. Some undocumented workers want to comply with the law and pay the income taxes they owe. This practice should not be discouraged, as the tax law applies with equal force to legal and illegal residents of the United States.

However, ITINs have been criticized for their use by illegal immigrants and undocumented workers. A recent report found that individuals who are not authorized to work in the United States were paid \$4.2 billion in refundable tax credits, such as the child tax credit, because they were able to file tax returns using an ITIN.

**GLOBAL TAX ISSUES:** The **Global Tax Issues** feature gives insight into the ways in which taxation is affected by international concerns and illustrates the effects of various events on tax liabilities across the globe.



# Take your students from Motivation to Mastery with CengageNOWv2

CengageNOWv2 is a powerful course management tool and online homework resource that elevates student thinking by providing superior content designed with the entire student workflow in mind.



- ☐ **MOTIVATION:** engage students and better prepare them for class
- ☐ **APPLICATION:** help students learn problem-solving behavior and skills to guide them to complete taxation problems on their own
- ☐ **MASTERY:** help students make the leap from memorizing concepts to actual critical thinking

## Motivation —

To help with student engagement and preparedness, CengageNOWv2 for SWFT offers:

- ☐ **“Tax Drills” test students on key concepts and applications.** With three to five questions per learning objective, these “quick-hit” questions help students prepare for class lectures or review prior to an exam.



## Application —

Students need to learn problem-solving behavior and skills, to guide them to complete taxation problems on their own. However, as students try to work through homework problems, sometimes they become stuck and need extra help. To reinforce concepts and keep students on the right track, CengageNOWv2 for SWFT offers the following.

- ☐ **End-of-chapter homework from the text** is expanded and enhanced to follow the workflow a professional would use to solve various client scenarios. These enhancements better engage students and encourage them to think like a tax professional.



- ❑ **Algorithmic versions** of end-of-chapter homework are available for computational exercises and at least 15 problems per chapter.
- ❑ **“Check My Work” Feedback.** Homework questions include immediate feedback so students can learn as they go. Levels of feedback include an option for “check my work” prior to submission of an assignment.
- ❑ **Post-Submission Feedback.** After submitting an assignment, students receive even more extensive feedback explaining why their answers were incorrect. Instructors can decide how much feedback their students receive and when, including the full solution.
- ❑ **Built-in Test Bank** for online assessment.

## Mastery —

- ❑ **Tax Form Problems** give students the option to complete the Cumulative Intuit ProConnect Tax problems and other homework items found in the end-of-chapter manually or in a digital environment.
- ❑ **An Adaptive Study Plan** comes complete with an eBook, practice quizzes, glossary, and flashcards. It is designed to help give students additional support and prepare them for the exam.

**CengageNOWv2 Instant Access Code**  
**ISBN: 978-0-357-74948-7** (two-semester access)

Contact your Cengage Learning Consultant about different bundle options.

The image displays two screenshots of the Intuit ProConnect Tax software interface. The top screenshot shows the 'Form 1040' tab selected, with the '1040 U.S. Individual Income Tax Return' for 2020. The form is partially filled out, showing the filer's name as 'Janice Morgan' and her social security number as '123-45-6782'. The bottom screenshot shows the 'Form 1040' tab selected, with the '1040 U.S. Individual Income Tax Return' for 2020. The form is partially filled out, showing the filer's name as 'Janice Morgan' and her social security number as '123-45-6782'.

## EXTENSIVELY REVISED. DEFINITELY UP TO DATE.

Each year the *South-Western Federal Taxation* series is updated with thousands of changes to each text. Some of these changes result from the feedback we receive from instructors and students in the form of reviews, focus groups, web surveys, and personal e-mail correspondence to our authors and team members. Other changes come from our careful analysis of the evolving tax environment. **We make sure that every tax law change relevant to the introductory taxation course was considered, summarized, and fully integrated into the revision of text and supplementary materials.**

The *South-Western Federal Taxation* authors have made every effort to keep all materials up to date and accurate. All chapters contain the following general changes for the 2022 edition.

- Updated materials to reflect changes made by Congress through legislative action (including the tax provisions contained in the CARES Act, the Consolidated Appropriations Act of 2021, and the American Rescue Plan Act of 2021).
- Streamlined chapter content (where applicable) to clarify material and make it easier for students to understand.
- Revised numerous materials as the result of changes caused by indexing of statutory amounts.
- Revised Problem Materials, Computational Exercises, and CPA Exam problems.
- Updated Chapter Outlines to provide an overview of the material and to make it easier to locate specific topics.
- Revised *Financial Disclosure Insights* and *Global Tax Issues* as to current developments.

In addition, the following materials are available online.

- An appendix that helps instructors broaden and customize coverage of important tax provisions of the Affordable Care Act. (Instructor Companion Website at [www.cengage.com/login](http://www.cengage.com/login))
- An appendix that covers depreciation and the Accelerated Cost Recovery System (ACRS). (Instructor Companion Website at [www.cengage.com/login](http://www.cengage.com/login))
- An appendix that has comprehensive tax return problems for the 2020 tax filing year (Appendix F). (Instructor Companion Website at [www.cengage.com/login](http://www.cengage.com/login))

### Chapter 1

- Removed Exhibit 1.4 (on IRS audit types), but retained text discussion.
- Expanded judicial concepts to also include judicial doctrines and added new text and example on the substance over form doctrine.
- Updated end-of-chapter materials as needed.

### Chapter 2

- Minor changes made to various exhibits and concept summaries.
- Updated references and citations throughout the chapter.
- Expanded Internal Revenue Bulletin coverage to include IRS Notices.
- Changed references to RIA Checkpoint to Thomson Reuters Checkpoint.
- Updated end-of-chapter materials as needed.

### Chapter 3

- Updated chapter materials to reflect changes to Form 1040 and related schedules; updated exhibit summarizing when Form 1040 Schedules 1 through 3 are used.
- Updated explanation and examples of the child tax credit to reflect 2021 changes made by the American Rescue Plan Act of 2021.
- Updated chapter materials to reflect 2021 inflation adjustments.
- Updated material on virtual currency (including revised question on page 1 of Form 1040).
- Updated exhibit summarizing the 0, 15, and 20% breakpoints for the alternative tax on net capital gains.
- Revised and clarified materials (including end-of-chapter materials) as needed.

### Chapter 4

- The discussion of Income Received by an Agent was moved to text Section 4-2 with the discussion of the timing of income recognition.
- Updated Global Tax Issues feature entitled “From ‘All Sources’ Is a Broad Definition” for the number of recent expatriations.

- Added Ethics & Equity feature on the expansion of unemployment benefits during the COVID-19 pandemic.
- Noted the 2020 unemployment compensation exclusion added by the American Rescue Plan Act of 2021.
- Added two examples illustrating the relationship of the all-events test to financial reporting.
- Added example of potential income shifting to a taxpayer not subject to the kiddie tax to highlight the general benefits of income shifting and the impact of the kiddie tax on this benefit.
- Deleted former homework Problem 55 that required completion of Worksheet 1, Figuring Your Taxable Benefits, from IRS Publication 915.

## Chapter 5

- Modified Learning Objective 1 to address the definition of exclusions and that they are distinguishable from items that are not income.
- Combined the learning objective on cancellation of debt with the learning objective related to other exclusions.
- Renamed text Section 5-1 as “Income Exclusions.”
- Moved material on corporate distributions from text Section 5-11 to new text Section 5-1b, to illustrate an example of something received that is not income.
- Moved and renamed former text Section 5-16 as text Section 5-14 to improve flow of chapter materials.
- The discussion of corporate payments called “dividends” (but not considered dividends for tax purposes) was moved to Chapter 4 (as part of gross income discussion).
- Updated text, examples, and end-of-chapter materials as needed, including 2021 inflation adjustments.

## Chapter 6

- Revised and updated chapter materials as needed; clarified chapter materials when necessary.
- Updated text for inflation-adjusted items.

- Replaced summary of a *Fortune* article on executive compensation with summary of a *Wall Street Journal* article (text Section 6-4c).
- Revised and updated end-of-chapter materials as needed (including changes needed to reflect revised inflation-adjusted items).
- Modified items in tax form and tax computation problems to be more reflective of current income levels.

## Chapter 7

- Cited a recent Tax Court decision that provides a comprehensive overview of the law related to worthless securities [*MCM Investment Management, LLC* (T.C.Memo. 2019–158)].
- Updated text to include discussion of COVID-19 casualties (and the ability to deduct these in the year prior to the loss).
- Added a new example (Example 27) demonstrating how to amortize research and experimentation expenditures incurred in taxable years beginning after December 31, 2021.
- Noted (in footnote 37) the retroactive delay of the excess business loss provision by the CARES Act (revised effective date is taxable years beginning after December 31, 2020).
- Modified the net operating loss materials to reflect changes made by the CARES Act.
- Added new part to Problem 40 to allow students to compute the appropriate deduction for research and experimentation expenditures incurred in taxable years beginning after December 31, 2021; also added a related question to the text bank and modified an essay question.
- Updated remainder of chapter materials as needed (including various inflation-adjusted amounts).

## Chapter 8

- Updated chapter materials to reflect inflation adjustments to § 179 (including SUVs) and luxury automobiles.
- Updated Form 4562 and Schedule C (Form 1040) to 2020 forms.
- Updated and revised remainder of text and end-of-chapter materials as needed.

## Chapter 9

- Updated text and end-of-chapter materials for revised standard mileage amounts; updated materials on retirement plans.
- Deleted coverage of § 222 (repealed as part of Consolidated Appropriations Act of 2021).
- Revised and clarified materials based on feedback from adopters.

## Chapter 10

- Revised and clarified text as needed, including 2021 change to medical expense AGI floor (now permanently set at 7.5% of AGI).
- Added brief comment on CARES Act cash charitable contribution for non-itemizers (a *for* AGI deduction).
- Updated text for annual inflation adjustments.
- Updated end-of-chapter materials as needed.

## Chapter 11

- Made minor changes to Learning Objectives 2 and 4.
- Updated chapter materials to reflect inflation adjustments.
- Added new research problem on virtual currency investing and software tools to help track the necessary information for tax reporting.
- Updated end-of-chapter materials as needed.

## Chapter 12

- Updated for changes to various individual credits by the American Rescue Plan Act of 2021.
- Reorganized presentation of credits to show those available to businesses, to individuals, and to both types of taxpayers.
- Updated Ethics & Equity scenarios to reflect current tax law considerations.
- Added a problem on the AMT.
- Updated problems, improved readability.
- Added an exhibit summarizing various energy credits (Exhibit 12.4).
- Updated Affordable Care Act materials.

## Chapter 13

- Revised introductory discussion of realized gains and losses (text Section 13-1a).
- Expanded the discussion of basis when a liability is involved, adding Example 7.
- Reduced the discussion of basis computations, deleting former Example 11.

## Chapter 14

- Updated Exhibit 14.1 summarizing 2021 and 2020 break points for the 0%/15%/20% alternative tax rates on net capital gains and qualified dividend income.
- Updated text and end-of-chapter materials for 2021 inflation adjustments to Tax Rate Schedules and alternative tax rate brackets (for net capital gains).
- Enhanced text materials, Concept Summary 14.6, and Concept Summary 14.8 to show integration with the capital gain materials more clearly.

## Chapter 15

- Updated chapter materials to reflect 2021 inflation adjustments to QBI deduction threshold limits.
- Updated example illustrating the completion of 2020 Form 8995-A and Schedule A (Form 8995-A).
- Revised and clarified materials based on feedback from adopters.
- Updated end-of-chapter materials as needed (including revisions for inflation adjustments to QBI deduction threshold limits and completion of 2020 Form 8995).

## Chapter 16

- Removed discussion of conditions for granting approval to change an accounting period.
- Replaced a research problem with one involving a sole proprietor and the constructive receipt doctrine (and added a communications requirement).

## Chapter 17

- Updated and revised text and end-of-chapter materials as needed.
- Noted the changes to the excessive executive compensation rule made by the American Rescue Plan Act of 2021.
- Added a new research problem focused on the CARES Act.

## Chapter 18

- Switched Learning Objectives 2 and 3 to allow for better understanding of the relevance of stock basis.
- Switched text Sections 18-1e and 18-1f to enhance student comprehension.
- Reversed the order of discussion of assigning basis in § 351 transactions and the effect of liabilities transferred to a corporation on stock and asset bases.
- Added a test bank problem on § 1202.

## Chapter 19

- Revised and updated chapter materials as needed; clarified chapter materials when necessary.
- Updated end-of-chapter materials as needed.

## Chapter 20

- Revised and updated chapter materials as needed; clarified chapter materials when necessary.
- Retitled text Sections 20-5b and 20-5c.
- Updated end-of-chapter materials as needed.
- Added and replaced several new items.
- Replaced Research Problem 2.

## Chapter 21

- Added Concept Summary 21.4 entitled “Comparing a Partner’s Tax Basis and Capital Account.”
- Show reporting of guaranteed payments split between those for services versus use of capital as changed by the IRS on Schedule K-1.

- Added new “formula” version of Excel spreadsheet for current distributions in Problems 24 and 25.
- Replaced calculation spreadsheets to correct typo in Problems 24 and 25.
- Expanded response to part (b) of Problem 28.
- Added new “formula” version of Excel spreadsheet for liquidating distributions in Problem 29.
- Added calculation spreadsheets supporting answers in Problem 29.

## Chapter 22

- Revised Learning Objectives 1, 9, and 10.
- Changed titles for text Sections 22-3a, 22-3d, and 22-3e.
- Revised Exhibit 22.1 comparing business entities.
- Revised introductory material in text Section 22-1.
- Updated statistics about S corporations and partnerships/LLCs.
- Deleted Exhibit 22.5.
- Revised material in text Sections 22-3f and 22-3g.
- Placed Discussion Questions, Computational Exercises, and Problems in chronological learning objective order.
- Added two new research problems, one involving data analytics.

## Chapter 23

- Revised Learning Objective 5.
- Revised titles of text Sections 23-2c, 23-7a, and 23-7c.
- Updated statistics about the nonprofit sector of the economy, for private foundations, and for the UBIT.
- Updated statistics about the tax on university endowments and the applications for exempt status.
- Added material about the UBIT “silo” rule.
- Deleted some material from the discussion of debt-financed UBTI.



- Added material concerning the loss of exempt status due to a failure to file Form 990.
- Updated end-of-chapter materials as needed, including revising Research Problem 6 and adding new Research Problem 7 (communications and data analytics).
- Added new Research Problem 7 (communications and data analytics).

## Chapter 24

- Added information on the MTC's project to update its *Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272*, for changes in business practices primarily due to technology.

## Chapter 25

- Revised Learning Objectives 3 and 5.
- Replaced a Global Tax Issues feature ("COVID-19 and Permanent Residency").
- Revised the discussion of tax treaties (text Section 25-2).
- Updated and added statistics about the global economy, worldwide tax rates, treaty withholding rates, advance pricing agreements, FTC deferrals, and CFCs.
- Revised Concept Summary 25.4 (which now illustrates the components of Subpart F income).
- Deleted text Section 25-5b ("Creating a Cross-Border Entity").
- Revised and expanded the discussion of Global Intangible Low-Taxed Income (GILTI).
- Added a number of new examples to illustrate text materials.
- Revised Research Problem 6, which asks students to explore and report on OECD base erosion and profit shifting (BEPS) developments.

## Chapter 26

- Made minor revisions to Learning Objectives 2 and 6.
- Added text Section 26-3f ("Ethics in the Tax Practice").
- Updated and expanded statistics about the IRS workforce and budget, tax filings, offers in compromise, penalties, and audit rates and results.
- Updated and reorganized the material on informants.
- Updated the Ethics & Equity item about self-assessment.
- Expanded materials about the unauthorized practice of law.
- Added a research problem about the timely filing of tax returns.

## Chapter 27

- Revised Learning Objectives 1, 2, 5, 8, and 9.
- Updated statistics about estate and gift tax returns filed.
- Rearranged and revised material in text Section 27-2a.
- Revised material in Concept Summary 27-3.
- Revised introductory material in text Section 27-3.
- Revised and rearranged material concerning life insurance in the gross estate.
- Updated information about estate and gift tax treaties with other countries.
- Replaced a research problem with a new data analytics problem.
- Revised titles for text Section 27-1b.
- Updated statistics about the net worth of U.S. households.
- Expanded the list of requirements for using a buy-sell agreement.
- Revised the discussion of the § 1014(e) rule.
- Expanded material in text Section 27-3b.
- Added material on charitable gifts using donor-advised funds.

## Chapter 28

- Revised Learning Objective 1 and added a new learning objective.
- Revised title of text Section 28-1.
- Expanded statistics about Forms 1041 filed.
- Updated tax amounts in Exhibit 28.3.
- Added information about entity tax rates for net long-term capital gains.
- Augmented explanation in Example 4.
- Revised the Ethics & Equity items on pet-assistance trusts and choice of trustee.
- Added a new text Section 28-5 entitled “Grantor Trusts.”
- Replaced a research problem with a new data analytics and communications problem.

## TAX LAW OUTLOOK

### *From your SWFT Series Editors:*

Legislation related to the COVID-19 pandemic was a vehicle for tax changes in 2020. And, a variety of tax changes were incorporated into the American Rescue Plan Act of 2021 (enacted in March 2021). The Biden administration and 117th Congress began to discuss a wide variety of tax law changes, including changes to the Tax Cuts and Jobs Act of 2017 (TCJA). Still others are expected in the Biden administration’s Build Back Better plan (with legislation likely to be discussed and possibly enacted before the end of the 117th Congress).

Taxpayers and their advisers will need to evaluate how these changes will affect their short- and long-term planning (adjusting those plans appropriately). The SWFT editors will be monitoring these activities and provide updates to adopters as needed.

## SUPPLEMENTS SUPPORT STUDENTS AND INSTRUCTORS

Built around the areas students and instructors have identified as the most important, our integrated supplements package offers more flexibility than ever before to suit the way instructors teach and students learn.

### Online and Digital Resources for Students



CengageNOWv2 is a powerful course management and online homework tool that provides robust instructor control and customization to optimize the student learning experience and meet desired outcomes.

#### CengageNOWv2 Instant Access Code ISBN:

978-0-357-74948-7 (two-semester access)

Contact your Cengage Learning Consultant about different bundle options.



#### Thomson Reuters Checkpoint™

is the leading online tax research database used by professionals. Checkpoint™ helps introduce students to tax research in three simple ways:

- Intuitive web-based design makes it fast and simple to find what you need.
- Checkpoint™ provides a comprehensive collection of primary tax law, cases, and rulings along with analytical insight you simply can't find anywhere else.
- Checkpoint™ has built-in productivity tools such as calculators to make research more efficient—a resource more tax pros use than any other.

Six months' access to Checkpoint™ (after activation) is packaged automatically with every NEW copy of the textbook.\*

### ProConnect™ Tax

More than software: Put the experience of ProConnect™ Tax on your side.

- Get returns done right the first time with access to all the forms you need, backed by industry-leading calculations and diagnostics.
- Save time with logical data-entry worksheets instead of traditional forms-based methods.
- It's all online, so there's nothing to install or maintain.

Online access to ProConnect™ Tax software is offered with each NEW copy of the textbook—at no additional cost to students.\*

### www.cengage.com

Students can use **www.cengage.com**

to select this textbook and access Cengage Learning content, empowering them to choose the most suitable format and giving them a better chance of success in the course. Buy printed materials, eBooks, and digital resources directly through Cengage Learning and save at **www.cengage.com**.

### Online Student Resources

Students can go to **www.cengage.com** for free resources to help them study as well as the opportunity to purchase additional study aids. These valuable free study resources will help students earn a better grade:

- Flashcards use chapter terms and definitions to aid students in learning tax terminology for each chapter.
- Online glossary for each chapter provides terms and definitions from the text in alphabetical order for easy reference.
- Learning objectives can be downloaded for each chapter to help keep students on track.
- Tax tables used in the textbook are downloadable for reference.



The first-of-its-kind digital subscription designed specially to lower costs.

Students get total access to everything Cengage has to offer on demand—in one place. That's 20,000 eBooks, 2,300 digital learning products, and dozens of study tools across 70 disciplines and over 675 courses. **www.cengage.com/unlimited**

### Printed Resources for Students

#### Looseleaf Edition (978-0-357-51103-9)

This version provides all the pages of the text in an unbound, three-hole-punched format for portability and ease of use. Online access to ProConnect™ Tax software is included with every NEW textbook as well as Checkpoint™ from Thomson Reuters.\*

\*NEW printed copies of the textbook are automatically packaged with access to Checkpoint™ and ProConnect™ Tax software. If students purchase the eBook, they will not automatically receive access to Checkpoint™ and ProConnect™ Tax software.

## Comprehensive Supplements Support Instructors' Needs



CengageNOWv2 is a powerful course management and online homework tool that provides robust instructor control and customization to optimize the student learning experience and meet desired outcomes. In addition to the features and benefits mentioned earlier for students, CengageNOWv2 includes these features for instructors:

- **Learning Outcomes Reporting** and the ability to analyze student work from the gradebook. Each exercise and problem is tagged by topic, learning objective, level of difficulty, estimated completion time, and business program standards to allow greater guidance in developing assessments and evaluating student progress.
- **Built-in Test Bank for online assessment.** The Test Bank files are included in CengageNOWv2 so that they may be used as additional homework or tests.

### Solutions Manual

Written by the *South-Western Federal Taxation* editors and authors, the Solutions Manual features solutions arranged in accordance with the sequence of chapter material.

Solutions to all homework items are tagged with their Estimated Time to Complete, Level of Difficulty, and Learning Objective(s), as well as the AACSB's and AICPA's core competencies—giving instructors more control than ever in selecting homework to match the topics covered. The Solutions Manual also contains the solutions to Appendix F: Comprehensive Tax Return Problems and answers with explanations to the end-of-chapter Becker CPA Review Questions. **Available on the Instructor Companion Website at [www.cengage.com/login](http://www.cengage.com/login).**

### PowerPoint® Lectures with Notes

The Instructor PowerPoint® Lectures contain more than 30 slides per chapter, including outlines and instructor guides, concept definitions, and key points. **Available on the Instructor Companion Website at [www.cengage.com/login](http://www.cengage.com/login).**

### Test Bank

Written by the *South-Western Federal Taxation* editors and authors, the Test Bank contains approximately 2,200 items and solutions arranged in accordance with the sequence of chapter material.

Each test item is tagged with its Estimated Time to Complete, Level of Difficulty, and Learning Objective(s), as well as the AACSB's and AICPA's core competencies—for easier instructor planning and test item selection. The 2022 Test Bank is available in Cengage's test generator software, Cognero.

Cengage Learning Testing Powered by Cognero is a flexible, online system that allows you to:

- author, edit, and manage Test Bank content from multiple Cengage Learning solutions
- create multiple test versions in an instant
- deliver tests from your LMS, your classroom, or wherever you want
- create tests from school, home, the coffee shop—anywhere with internet access (No special installs or downloads needed.)

Test Bank files in Word format as well as versions to import into your LMS are available on the Instructor Companion Website. **Cognero Test Banks available via single sign-on (SSO) account at [www.cengage.com/login](http://www.cengage.com/login).**

### Other Instructor Resources

**All of the following instructor course materials are available online at [www.cengage.com/login](http://www.cengage.com/login).** Once logged into the site, instructors should select this textbook to access the online Instructor Resources.

- Instructor Guide
- Edition-to-edition correlation grids by chapter
- An appendix that helps instructors broaden and customize coverage of important tax provisions of the Affordable Care Act
- The Depreciation and the Accelerated Cost Recovery System (ACRS) appendix
- Comprehensive Tax Return Problems appendix

### Custom Solutions

Cengage Learning Custom Solutions develops personalized solutions to meet your taxation education needs. Consider the following for your adoption of *South-Western Federal Taxation 2022 Edition*.

- Remove chapters you do not cover or rearrange their order to create a streamlined and efficient text.
- Add your own material to cover additional topics or information.
- Add relevance by including sections from Sawyers/Gill's *Federal Tax Research* or your state's tax laws and regulations.

# ACKNOWLEDGMENTS

We want to thank all the adopters and others who participated in numerous online surveys as well as the following individuals who provided content reviews and feedback in the development of the ***South-Western Federal Taxation 2022 titles***.

**James C. Young / David M. Maloney / Annette Nellen / Mark B. Persellin / Andrew D. Cuccia**

Lindsay G. Acker, *University of Wisconsin-Madison*  
 Deborah S. Adkins, *Nperspective, LLC*  
 Mark P. Altieri, *Kent State University*  
 Susan E. Anderson, *Elon University*  
 Henry M. Anding, *Woodbury University*  
 Jennifer A. Bagwell, *Ohio University*  
 George Barbi, *Lanier Technical College*  
 Terry W. Bechtel, *Texas A&M University – Texarkana*  
 Chris Becker, *LeMoyne College*  
 Tamara Berges, *UCLA*  
 Ellen Best, *University of North Georgia*  
 Tim Biggart, *Berry College*  
 Rachel Birkey, *Illinois State University*  
 Israel Blumenfrecht, *Queens College*  
 Patrick M. Borja, *Citrus College / California State University, Los Angeles*  
 Dianne H. Boseman, *Nash Community College*  
 Cathalene Bowler, *University of Northern Iowa*  
 Madeline Brogan, *Lone Star College – Montgomery*  
 Darryl L. Brown, *Illinois Wesleyan University*  
 Timothy G. Bryan, *University of Southern Indiana*  
 Robert S. Burdette, *Salt Lake Community College*  
 Ryan L. Burger, *Concordia University Nebraska*  
 Lisa Busto, *William Rainey Harper College*  
 Julia M. Camp, *Providence College*  
 Al Case, *Southern Oregon University*  
 Machiavelli W. Chao, *Merage School of Business, University of California, Irvine*  
 Eric Chen, *University of Saint Joseph*  
 Christine Cheng, *Louisiana State University*  
 James Milton Christianson, *Southwestern University and Austin Community College*  
 Wayne Clark, *Southwest Baptist University*  
 Ann Burstein Cohen, *University at Buffalo, The State University of New York*  
 Ciril Cohen, *Fairleigh Dickinson University*  
 Seth Colwell, *University of Texas - Rio Grande Valley*  
 Dixon H. Cooper, *University of Arkansas*  
 Rick L. Crosser, *Metropolitan State University of Denver*  
 John P. Crowley, *Castleton University*  
 Susan E. M. Davis, *South University*  
 Dwight E. Denman, *Newman University*

James M. DeSimpelare, *Ross School of Business at the University of Michigan*  
 John Dexter, *Northwood University*  
 James Doering, *University of Wisconsin – Green Bay*  
 Michael P. Donohoe, *University of Illinois at Urbana Champaign*  
 Deborah A. Doonan, *Johnson & Wales University*  
 Monique O. Durant, *Central Connecticut State University*  
 Wayne L. Edmunds, *Virginia Commonwealth University*  
 Rafi Efrat, *California State University, Northridge*  
 Frank J. Faber, *St. Joseph's College*  
 A. Anthony Falgiani, *University of South Carolina, Beaufort*  
 Jason Fiske, *Thomas Jefferson School of Law*  
 John Forsythe, *Eagle Gate College*  
 Alexander L. Frazin, *University of Redlands*  
 Carl J. Gabrini, *College of Coastal Georgia*  
 Kenneth W. Gaines, *East-West University, Chicago, Illinois*  
 Carolyn Galantine, *Pepperdine University*  
 Sheri Geddes, *Hope College*  
 Alexander Gelardi, *University of St. Thomas*  
 Joel Gelb, *Farleigh Dickinson University*  
 Daniel J. Gibbons, *Waubensee Community College*  
 Martie Gillen, *University of Florida*  
 Charles Gnizak, *Fort Hays State University*  
 J. David Golub, *Northeastern University*  
 George G. Goodrich, *John Carroll University*  
 Marina Grau, *Houston Community College – Houston, TX*  
 Vicki Greshik, *University of Jamestown College*  
 Jeffrey S. Haig, *Santa Monica College*  
 Marcye S. Hampton, *University of Central Florida*  
 June Hanson, *Upper Iowa University*  
 Donald Henschel, *Benedictine University*  
 Kenneth W. Hodges, *Sinclair Community College*  
 Susanne Holloway, *Salisbury University*  
 Susan A. Honig, *Herbert H. Lehman College*  
 Jeffrey L. Hoopes, *University of North Carolina*  
 Christopher R. Hoyt, *University of Missouri (Kansas City) School of Law*  
 Marsha M. Huber, *Youngstown State University*

Carol Hughes, *Asheville-Buncombe Technical Community College*  
 Helen Hurwitz, *Saint Louis University*  
 Richard R. Hutaff, *Wingate University*  
 Zite Hutton, *Western Washington University*  
 Steven L. Jager, *Cal State Northridge*  
 Janeé M. Johnson, *University of Arizona*  
 Brad Van Kalsbeek, *University of Sioux Falls*  
 John E. Karayan, *Woodbury University*  
 Carl Keller, *Missouri State University*  
 Cynthia Khanlarian, *Concord University*  
 Bob G. Kilpatrick, *Northern Arizona University*  
 Gordon Klein, *UCLA Anderson School*  
 Taylor Klett, *Sam Houston State University*  
 Aaron P. Knappe, *Peru State College*  
 Cedric Knott, *Colorado State University – Global Campus*  
 Ausher M. B. Kofsky, *Western New England University*  
 Emil Koren, *Saint Leo University*  
 Jack Lachman, *Brooklyn College – CUNY*  
 Richard S. Leaman, *University of Denver*  
 Adena LeJeune, *Louisiana College*  
 Gene Levitt, *Mayville State University*  
 Teresa Lightner, *University of North Texas*  
 Sara Linton, *Roosevelt University*  
 Roger Lirely, *The University of Texas at Tyler*  
 Jane Livingstone, *Western Carolina University*  
 Heather Lynch, *Northeast Iowa Community College*  
 Michael J. MacDonald, *University of Wisconsin-Whitewater*  
 Mabel Machin, *Florida Institute of Technology*  
 Maria Alaina Mackin, *ECPI University*  
 Anne M. Magro, *George Mason University*  
 Richard B. Malamud, *California State University, Dominguez Hills*  
 Harold J. Manasa, *Winthrop University*  
 Barry R. Marks, *University of Houston – Clear Lake*  
 Dewey Martin, *Husson University*  
 Anthony Masino, *East Tennessee State University*  
 Norman Massel, *Louisiana State University*  
 Bruce W. McClain, *Cleveland State University*  
 Jeff McGowan, *Trine University*  
 Allison M. McLeod, *University of North Texas*  
 Meredith A. Menden, *Southern New Hampshire University*  
 Robert H. Meyers, *University of Wisconsin-Whitewater*  
 John G. Miller, *Skyline College*



Tracie L. Miller-Nobles, *Austin Community College*  
 Jonathan G. Mitchell, *Stark State College*  
 Richard Mole, *Hiram College*  
 David Morack, *Lakeland University*  
 Lisa Nash, *University of North Georgia*  
 Mary E. Netzler, *Eastern Florida State College*  
 Joseph Malino Nicassio, *Westmoreland County Community College*  
 Mark R. Nixon, *Bentley University*  
 Garth Novack, *Pantheon Heavy Industries & Foundry*  
 Claude R. Oakley, *DeVry University, Georgia*  
 Al Oddo, *Niagara University*  
 Sandra Owen, *Indiana University – Bloomington*  
 Vivian J. Paige, *Old Dominion University*  
 Carolyn Payne, *University of La Verne*  
 Ronald Pearson, *Bay College*  
 Thomas Pearson, *University of Hawaii at Manoa*  
 Nichole L. Pendleton, *Friends University*  
 Chuck Pier, *Angelo State University*  
 Lincoln M. Pinto, *DeVry University*  
 Sonja Pippin, *University of Nevada – Reno*  
 Steve Platau, *The University of Tampa*  
 Elizabeth Plummer, *TCU*  
 Walfyette Powell, *Strayer University*  
 Darlene Pulliam, *West Texas A&M University*  
 Thomas J. Purcell, *Creighton University*  
 John S. Repsis, *University of Texas at Arlington*

John D. Rice, *Trinity University*  
 Jennifer Hardwick Robinson, *Trident Technical College*  
 Shani N. Robinson, *Sam Houston State University*  
 Donald Roth, *Dordt College*  
 Richard L. Russell, *Jackson State University*  
 Robert L. Salyer, *Northern Kentucky University*  
 Rhoda Sautner, *University of Mary*  
 Bunney L. Schmidt, *Keiser University*  
 Allen Schuldenfrei, *University of Baltimore*  
 Eric D. Schwartz, *LaRoche College*  
 Tony L. Scott, *Norwalk Community College*  
 Randy Serrett, *University of Houston – Downtown*  
 Wayne Shaw, *Southern Methodist University*  
 Paul A. Shoemaker, *University of Nebraska – Lincoln*  
 Kimberly Sipes, *Kentucky State University*  
 Georgi Smatrakalev, *Florida Atlantic University*  
 Randy Smit, *Dordt College*  
 Leslie S. Sobol, *California State University Northridge*  
 Eric J. Sommermeyer, *Wartburg College*  
 Marc Spiegel, *University of California, Irvine*  
 Teresa Stephenson, *University of Wyoming*  
 Beth Stetson, *Oklahoma City University*  
 Debra Stone, *Eastern New Mexico University*  
 Frances A. Stott, *Bowling Green State University*  
 Todd S. Stowe, *Southwest Florida College*

Julie Straus, *Culver-Stockton College*  
 Martin Stub, *DeVry University*  
 James Sundberg, *Eastern Michigan University*  
 Kent Swift, *University of Montana*  
 Robert L. Taylor, *Lees-McRae College*  
 Francis C. Thomas, *Richard Stockton College of New Jersey*  
 Randall R. Thomas, *Upper Iowa University*  
 Ronald R. Tidd, *Central Washington University*  
 MaryBeth Tobin, *Bridgewater State University*  
 James P. Trebbby, *Marquette University*  
 Heidi Tribunella, *University of Rochester*  
 James M. Turner, *Georgia Institute of Technology*  
 Anthony W. Varnon, *Southeast Missouri State University*  
 Adria Palacios Vasquez, *Texas A&M University – Kingsville*  
 Terri Walsh, *Seminole State College of Florida*  
 Natasha R. Ware, *Southeastern University*  
 Mark Washburn, *Sam Houston State University*  
 Bill Weispfenning, *University of Jamestown (ND)*  
 Kent Williams, *Indiana Wesleyan University*  
 Candace Witherspoon, *Valdosta State University*  
 Sheila Woods, *DeVry University, Houston, TX*  
 Xinmei Xie, *Woodbury University*  
 Thomas Young, *Lone Star College – Tomball*

## SPECIAL THANKS

We are grateful to the faculty members who have diligently worked through the problems and test questions to ensure the accuracy of the **South-Western Federal Taxation** homework, solutions manuals, test banks, and comprehensive tax form problems. Their comments and corrections helped us focus on clarity as well as accuracy and tax law currency. We also thank Thomson Reuters for its permission to use Checkpoint™ with the text.

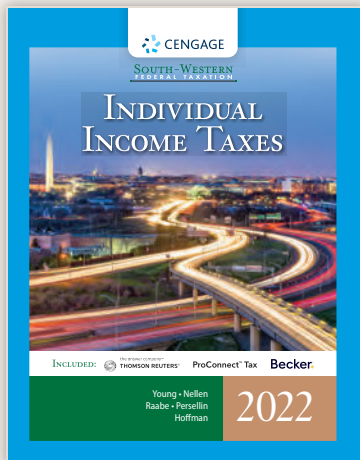
Sandra A. Augustine, (retired) *Hilbert College*  
 Robyn Dawn Jarnagin, *University of Arkansas*  
 Kate Mantzke, *Northern Illinois University*  
 Ray Rodriguez, *Murray State University*  
 Miles Romney, *Florida State University*

George R. Starbuck, *McMurry University*  
 Donald R. Trippeer, *State University of New York College at Oneonta*  
 Raymond Wacker, *Southern Illinois University, Carbondale*

Michael Weissenfluh, *Tillamook Bay Community College*  
 Marvin Williams, *University of Houston-Downtown*

# The South-Western Federal Taxation Series

To find out more about these books, go to [www.cengage.com](http://www.cengage.com).



## INDIVIDUAL INCOME TAXES, 2022 EDITION

**(YOUNG, NELLEN, RAABE, PERSELLIN, HOFFMAN, Editors)**

provides accessible, comprehensive, and authoritative coverage of the relevant tax code and regulations as they pertain to the individual taxpayer, as well as coverage of all major developments in Federal taxation.

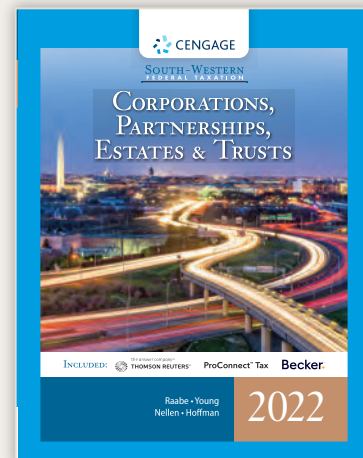
**(ISBN 978-0-357-51907-3)**

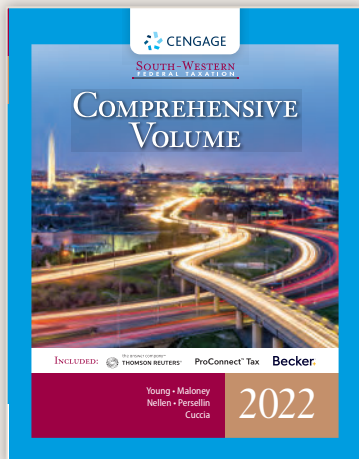
## CORPORATIONS, PARTNERSHIPS, ESTATES & TRUSTS, 2022 EDITION

**(RAABE, YOUNG, NELLEN, HOFFMAN, Editors)**

covers tax concepts as they affect corporations, partnerships, estates, and trusts. The authors provide accessible, comprehensive, and authoritative coverage of relevant tax code and regulations, as well as all major developments in Federal income taxation. This market-leading text is intended for students who have had a previous course in tax.

**(ISBN 978-0-357-51924-0)**





### COMPREHENSIVE VOLUME, 2022 EDITION

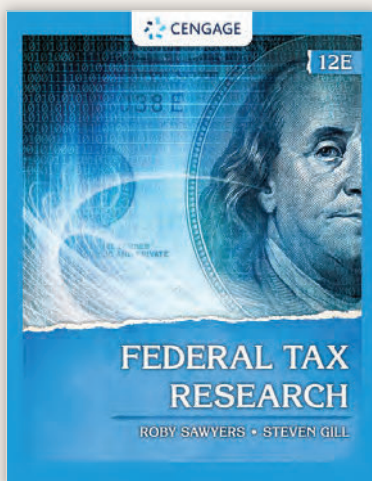
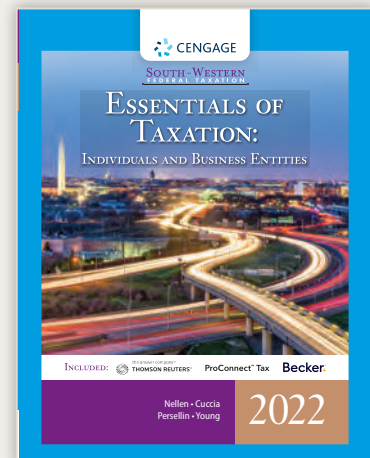
**(YOUNG, MALONEY, NELLEN, PERSELLIN, CUCCIA, Editors)** Combining the number one individual tax text with the number one corporations text, *Comprehensive Volume, 2022 Edition* is a true winner. An edited version of the first two ***South-Western Federal Taxation*** textbooks, this book is ideal for undergraduate or graduate levels. This text works for either a one-semester course in which an instructor wants to integrate coverage of individual and corporate taxation or for a two-semester sequence in which the use of only one book is desired.

**(ISBN 978-0-357-51101-5)**

### ESSENTIALS OF TAXATION: INDIVIDUALS & BUSINESS ENTITIES, 2022 EDITION

**(NELLEN, CUCCIA, PERSELLIN, YOUNG, Editors)** emphasizes tax planning and the multidisciplinary aspects of taxation. This text is designed with the AICPA Model Tax Curriculum in mind, presenting the introductory Federal taxation course from a business entity perspective. Its **Tax Planning Framework** helps users fit tax planning strategies into an innovative pedagogical framework. The text is an ideal fit for programs that offer only one course in taxation where users need to be exposed to individual taxation, as well as corporate and other business entity taxation. This text assumes no prior course in taxation has been taken.

**(ISBN 978-0-357-51943-1)**



### FEDERAL TAX RESEARCH, 12E

**(SAWYERS AND GILL)** *Federal Tax Research*, Twelfth Edition, offers hands-on tax research analysis and fully covers computer-oriented tax research tools. Also included in this edition is coverage on international tax research, a review of tax ethics, and many new real-life cases to help foster a true understanding of Federal tax law.

**(ISBN 978-0-357-36638-7)**

## ABOUT THE EDITORS

---



**James C. Young** is the PwC Professor of Accountancy at Northern Illinois University. A graduate of Ferris State University (B.S.) and Michigan State University (M.B.A. and Ph.D.), Jim's research focuses on taxpayer responses to the income tax using archival data. His dissertation received the PricewaterhouseCoopers/

American Taxation Association Dissertation Award, and his subsequent research has received funding from a number of organizations, including the Ernst & Young Foundation Tax Research Grant Program. His work has been published in a variety of academic and professional journals, including the *National Tax Journal*, *The Journal of the American Taxation Association*, and *Tax Notes*. Jim is a Northern Illinois University Distinguished Professor, received the Illinois CPA Society Outstanding Accounting Educator Award in 2012, and has received university teaching awards from Northern Illinois University, George Mason University, and Michigan State University.



**David M. Maloney**, Ph.D., CPA, is the Carman G. Blough Professor of Accounting Emeritus at the University of Virginia's McIntire School of Commerce. He completed his undergraduate work at the University of Richmond and his graduate work at the University of Illinois at Urbana-Champaign. Upon joining the Virginia faculty

in January 1984, Dr. Maloney taught Federal taxation in the graduate and undergraduate programs and was a recipient of major research grants from the Ernst & Young and KPMG Foundations. Dr. Maloney has published work in numerous professional journals, including *Journal of Taxation*, *The Tax Adviser*, *Tax Notes*, *Corporate Taxation*, *Accounting Horizons*, *Journal of Taxation of Investments*, and *Journal of Accountancy*.





**Annette Nellen, J.D., CPA, CGMA**, directs San José State University's graduate tax program (MST) and teaches courses in tax research, tax fundamentals, accounting methods, property transactions, employment tax, ethics, leadership, and tax policy. Professor Nellen is a graduate of CSU Northridge, Pepperdine (MBA),

and Loyola Law School. Prior to joining SJSU in 1990, she was with a Big 4 firm and the IRS. At SJSU, Professor Nellen is a recipient of the Outstanding Professor and Distinguished Service Awards. Professor Nellen is an active member of the tax sections of the AICPA and American Bar Association. In 2013, she received the AICPA Arthur J. Dixon Memorial Award, the highest award given by the accounting profession in the area of taxation. Professor Nellen is the author of BloombergBNA Tax Portfolio, *Amortization of Intangibles*. She has published numerous articles in the *AICPA Tax Insider*, *Tax Adviser*, *Tax Notes State*, and *The Journal of Accountancy*. She has testified before the House Ways & Means and Senate Finance Committees and other committees on Federal and state tax reform. Professor Nellen maintains the 21st Century Taxation Website and blog (21stcenturytaxation.com) as well as Websites on tax policy and reform, virtual currency, and state tax issues (sjsu.edu/people/annette.nellen/).



**Mark B. Persellin, Ph.D., CPA, CFP®**, is the Ray and Dorothy Berend Professor of Accounting at St. Mary's University. He is a graduate of the University of Arizona (B.S.), the University of Texas at Austin (M.P.A. in Taxation), and the University of Houston (Ph.D.). He teaches Personal Income Tax, Busi-

ness Income Tax, and Research in Federal Taxation. Prior to joining St. Mary's University in 1991, Professor Persellin taught at Florida Atlantic University and Southwest Texas University (Texas State University) and worked on the tax staff of a Big 4 firm. His research has been published in numerous academic and professional journals including *The Journal of the American Taxation Association*, *The Accounting Educators' Journal*, *The Tax Adviser*, *The CPA Journal*, *Journal of Taxation*, *Corporate Taxation*, *The Tax Executive*, *TAXES—The Tax Magazine*, *Journal of International Taxation*, and *Practical Tax Strategies*. In 2003, Professor Persellin established the St. Mary's University Volunteer Income Tax Assistance (VITA) site, and he continues to serve as a trainer and reviewer at the site.



**Andrew D. Cuccia, Ph.D., CPA**, is the Steed Professor of Accounting at the University of Oklahoma. He is a graduate of Loyola University, New Orleans (B.B.A.), and the University of Florida (Ph.D.). Prior to entering academia, Andy practiced as a CPA with a Big 4 accounting firm. Before joining the University of Oklahoma, he was on the

faculty at Louisiana State University and the University of Illinois. His research focuses on taxpayer and tax professional judgment and decision making and has been published in several journals including *The Accounting Review*, *The Journal of Accounting Research*, *The Journal of the American Taxation Association*, and *Tax Notes*. He has taught undergraduate and graduate courses in income tax fundamentals as well as graduate courses in corporate tax, tax policy, and tax research. Andy is a past president of the American Taxation Association and a member of the American Accounting Association and the AICPA.





# Brief Contents

## **PART 1: INTRODUCTION AND BASIC TAX MODEL**

---

CHAPTER 1	AN INTRODUCTION TO TAXATION AND UNDERSTANDING THE FEDERAL TAX LAW	1-1
CHAPTER 2	WORKING WITH THE TAX LAW	2-1
CHAPTER 3	TAX FORMULA AND TAX DETERMINATION; AN OVERVIEW OF PROPERTY TRANSACTIONS	3-1

## **PART 2: GROSS INCOME**

---

CHAPTER 4	GROSS INCOME: CONCEPTS AND INCLUSIONS	4-1
CHAPTER 5	GROSS INCOME: EXCLUSIONS	5-1

## **PART 3: DEDUCTIONS AND CREDITS**

---

CHAPTER 6	DEDUCTIONS AND LOSSES: IN GENERAL	6-1
CHAPTER 7	DEDUCTIONS AND LOSSES: CERTAIN BUSINESS EXPENSES AND LOSSES	7-1
CHAPTER 8	DEPRECIATION, COST RECOVERY, AMORTIZATION, AND DEPLETION	8-1
CHAPTER 9	DEDUCTIONS: EMPLOYEE AND SELF-EMPLOYED-RELATED EXPENSES	9-1
CHAPTER 10	DEDUCTIONS AND LOSSES: CERTAIN ITEMIZED DEDUCTIONS	10-1
CHAPTER 11	INVESTOR LOSSES	11-1
CHAPTER 12	TAX CREDITS AND PAYMENTS	12-1

## **PART 4: PROPERTY TRANSACTIONS**

---

CHAPTER 13	PROPERTY TRANSACTIONS: DETERMINATION OF GAIN OR LOSS, BASIS CONSIDERATIONS, AND NONTAXABLE EXCHANGES	13-1
CHAPTER 14	PROPERTY TRANSACTIONS: CAPITAL GAINS AND LOSSES, § 1231, AND RECAPTURE PROVISIONS	14-1

## **PART 5: SPECIAL TAX COMPUTATIONS AND ACCOUNTING PERIODS AND METHODS**

---

CHAPTER 15	THE DEDUCTION FOR QUALIFIED BUSINESS INCOME FOR NONCORPORATE TAXPAYERS	15-1
CHAPTER 16	ACCOUNTING PERIODS AND METHODS	16-1

## **PART 6: CORPORATIONS**

---

CHAPTER 17	CORPORATIONS: INTRODUCTION AND OPERATING RULES	17-1
CHAPTER 18	CORPORATIONS: ORGANIZATION AND CAPITAL STRUCTURE	18-1
CHAPTER 19	CORPORATIONS: DISTRIBUTIONS NOT IN COMPLETE LIQUIDATION	19-1
CHAPTER 20	CORPORATIONS: DISTRIBUTIONS IN COMPLETE LIQUIDATION AND AN OVERVIEW OF REORGANIZATIONS	20-1

## **PART 7: FLOW-THROUGH ENTITIES**

---

CHAPTER 21	PARTNERSHIPS	21-1
CHAPTER 22	S CORPORATIONS	22-1

## **PART 8: ADVANCED TAX PRACTICE CONSIDERATIONS**

---

CHAPTER 23	EXEMPT ENTITIES	23-1
CHAPTER 24	MULTISTATE CORPORATE TAXATION	24-1
CHAPTER 25	TAXATION OF INTERNATIONAL TRANSACTIONS	25-1
CHAPTER 26	TAX PRACTICE AND ETHICS	26-1

## **PART 9: FAMILY TAX PLANNING**

---

CHAPTER 27	THE FEDERAL GIFT AND ESTATE TAXES	27-1
CHAPTER 28	INCOME TAXATION OF TRUSTS AND ESTATES	28-1





# Contents

## Part 1: Introduction and Basic Tax Model

### CHAPTER 1

#### AN INTRODUCTION TO TAXATION AND UNDERSTANDING THE FEDERAL TAX LAW

*The Big Picture: Family and Taxes—A Typical Year*

#### APPROACHING THE STUDY OF TAXATION

What Is Taxation?

Taxation in Our Lives

The Relevance of Taxation to Accounting and Finance Professionals

How to Study Taxation

#### A BRIEF HISTORY OF U.S. TAXATION

Early Periods

**Concept Summary:** *Individuals and Taxes*

Revenue Acts

Trends

#### TAX SYSTEM DESIGN

Legal Foundation

The Basic Tax Formula

Tax Principles

#### MAJOR TYPES OF TAXES

Property Taxes

Transaction Taxes

**Ethics & Equity:** *Making Good Use of Out-of-State Relatives*

Taxes on Transfers at Death

Gift Taxes

Income Taxes

Employment Taxes

Other U.S. Taxes

**Concept Summary:** *Overview of Taxes in the United States*

Proposed U.S. Taxes

**Global Tax Issues:** *VAT in USA?*

#### TAX ADMINISTRATION

Internal Revenue Service

The Audit Process

Statute of Limitations

Interest and Penalties

Tax Practice

**Global Tax Issues:** *Outsourcing of Tax Return Preparation*

#### UNDERSTANDING THE FEDERAL TAX LAW

Revenue Needs

Economic Considerations

Social Considerations

Equity Considerations

Political Considerations

Influence of the Internal Revenue Service

Influence of the Courts

Summary

**Refocus on the Big Picture:** *Family and Taxes—A Typical Year*

### CHAPTER 2

#### WORKING WITH THE TAX LAW

*The Big Picture: Importance of Tax Research*

#### TAX LAW SOURCES

Statutory Sources of the Tax Law

Administrative Sources of the Tax Law

**Ethics & Equity:** *Reporting Tax Fraud*

Judicial Sources of the Tax Law

**Concept Summary:** *Federal Judicial System: Trial Courts*

**Concept Summary:** *Judicial Sources*

Other Sources of the Tax Law

#### WORKING WITH THE TAX LAW—

##### TAX RESEARCH TOOLS

Commercial Tax Services

Using Electronic (Online) Tax Services

Noncommercial Electronic (Online) Tax Services

#### WORKING WITH THE TAX LAW—

##### TAX RESEARCH

Identifying the Problem

Refining the Problem

Locating the Appropriate Tax Law Sources

Assessing the Validity of Tax Law Sources

Arriving at the Solution or at Alternative Solutions

**Financial Disclosure Insights:** *Where Does GAAP Come From?*

Communicating Tax Research

1-23

1-24

1-25

1-25

1-26

1-27

1-27

1-28

1-29

1-31

1-32

1-33

1-34

1-35

2-1

2-1

2-1

2-2

2-2

2-6

2-7

2-10

2-12

2-15

2-17

2-18

2-18

2-19

2-19

2-19

2-20

2-20

2-21

2-22

2-22

2-23

2-25

2-26

2-26



**WORKING WITH THE TAX LAW—****TAX PLANNING**

Nontax Considerations	2-29
Components of Tax Planning	2-29
Tax Avoidance and Tax Evasion	2-30
Follow-Up Procedures	2-30
Tax Planning	2-31

**TAXATION ON THE CPA EXAMINATION**

Preparation Blueprints	2-31
Regulation Section	2-31

**CHAPTER 3****TAX FORMULA AND TAX DETERMINATION; AN OVERVIEW OF PROPERTY TRANSACTIONS**

<i>The Big Picture: A Divided Household</i>	3-1
<b>Framework 1040: Tax Formula for Individuals</b>	3-2

**TAX FORMULA**

<b>Concept Summary: Tax Formula for Individuals</b> (Components Integrated into the Text)	3-3
Components of the Tax Formula	3-3
Tax Formula—Correlation with Form 1040	3-8

**STANDARD DEDUCTION**

Basic and Additional Standard Deduction	3-13
Individuals Not Eligible for the Standard Deduction	3-14
Special Limitations on the Standard Deduction for Dependents	3-14

**EXEMPTIONS****DEPENDENTS**

Qualifying Child	3-15
<b>Concept Summary: Tiebreaker Rules for Claiming Qualified Child</b>	3-17
Qualifying Relative	3-17
Other Rules for Determining Dependents	3-21
Comparison of Dependent Categories	3-21
<b>Concept Summary: Tests for Dependents</b>	3-22
<b>Ethics &amp; Equity: Whose Qualifying Child Is He?</b>	3-22
Child and Dependent Tax Credits	3-22

**FILING STATUS AND FILING REQUIREMENTS**

Filing Status	3-25
<b>Global Tax Issues: Filing a Joint Return</b>	3-26
<b>Ethics &amp; Equity: Abandoned Spouse?</b>	3-29
Filing Requirements	3-29

**TAX DETERMINATION**

Tax Rates	3-31
Computation of Net Taxes Payable or Refund Due	3-32
Kiddie Tax—Unearned Income of Dependent Children	3-33

**TAX RETURN FILING PROCEDURES**

Selecting the Proper Form	3-35
---------------------------	------

The E-File Approach	3-36
When and Where to File	3-36
Modes of Payment	3-37

**GAINS AND LOSSES FROM PROPERTY TRANSACTIONS—IN GENERAL****3-37****GAINS AND LOSSES FROM PROPERTY TRANSACTIONS—CAPITAL GAINS AND LOSSES****3-38**

Definition of a Capital Asset	3-38
Determination of Net Capital Gain	3-38
Treatment of Net Capital Loss	3-39
Taxation of Net Capital Gain	3-39
Taxation of Virtual Currency	3-40

**TAX PLANNING****3-41**

Maximizing the Use of the Standard Deduction	3-41
Dependents	3-41
Taking Advantage of Tax Rate Differentials	3-42
Income of Certain Children	3-43
<b>Refocus on the Big Picture: A Divided Household</b>	3-43

**Part 2: Gross Income****CHAPTER 4****GROSS INCOME: CONCEPTS AND INCLUSIONS****4-1**

<i>The Big Picture: Calculation of Gross Income</i>	4-1
<b>Framework 1040: Tax Formula for Individuals</b>	4-2

**GROSS INCOME****4-3**

Definition	4-3
Recovery of Capital Doctrine	4-3
<b>Global Tax Issues: From "All Sources" Is a Broad Definition</b>	4-3
Economic and Accounting Concepts of Income	4-4
Financial Accounting Income versus Taxable Income	4-4
Form of Receipt	4-5

**TIMING OF INCOME RECOGNITION****4-6**

Taxable Year	4-6
Accounting Methods	4-6
Special Rules Applicable to Cash Basis Taxpayers	4-9
<b>Ethics &amp; Equity: Should the Tax Treatment of Government Bonds and Corporate Bonds Be Different?</b>	4-11
Special Rules Applicable to Accrual Basis Taxpayers	4-12

**GENERAL SOURCES OF INCOME AND TO WHOM THEY ARE TAXED****4-13**

Personal Services	4-13
Income from Property	4-14
Income from Partnerships, S Corporations, Trusts, and Estates	4-16
<b>Concept Summary: Taxation of Income and Distributions from Partnerships, S Corporations, Trusts, and Estates</b>	4-17
Income in Community Property States	4-17

<b>SPECIAL RULES RELATED TO CERTAIN ITEMS INCLUDED IN GROSS INCOME</b>	<b>4-19</b>		
Alimony and Separate Maintenance Payments	4-19	Wrongful Incarceration	5-10
<b>Concept Summary:</b> <i>Tax Treatment of Payments and Transfers Pursuant to Divorce Agreements and Decrees</i>	4-21	Workers' Compensation	5-10
Imputed Interest on Below-Market Loans	4-21	Accident and Health Insurance Benefits	5-10
<b>Concept Summary:</b> <i>Effect of Certain Below-Market Loans on the Lender and Borrower</i>	4-22	<b>EMPLOYER-SPONSORED ACCIDENT AND HEALTH PLANS</b>	<b>5-11</b>
<b>Concept Summary:</b> <i>Exceptions to the Imputed Interest Rules for Below-Market Loans</i>	4-24	Medical Reimbursement Plans	5-11
<b>Ethics &amp; Equity:</b> <i>Taxing "Made-Up" Income</i>	4-24	Long-Term Care Insurance Benefits	5-12
Income from Annuities	4-24	<b>MEALS AND LODGING</b>	<b>5-13</b>
Prizes and Awards	4-27	General Rules for the Exclusion	5-13
Unemployment Compensation	4-27	Other Housing Exclusions	5-14
<b>Ethics &amp; Equity:</b> <i>Tax Treatment of Unemployment Compensation</i>	4-28	<b>EMPLOYEE FRINGE BENEFITS</b>	<b>5-14</b>
Social Security Benefits	4-28	Specific Benefits	5-15
Income Earned from Foreign Bank and Financial Accounts and FBAR Rules	4-29	Cafeteria Plans	5-15
<b>TAX PLANNING</b>	<b>4-30</b>	Flexible Spending Plans	5-16
Minimize Income Included in Gross Income	4-30	General Classes of Excluded Benefits	5-16
Tax Deferral	4-30	<b>Ethics &amp; Equity:</b> <i>Fringe Benefits</i>	5-20
Shifting Income to Other Taxpayers	4-32	Group Term Life Insurance	5-20
<b>Refocus on the Big Picture:</b> <i>Calculation of Gross Income</i>	4-33	<b>FOREIGN EARNED INCOME</b>	<b>5-21</b>
<b>CHAPTER 5</b>		<b>Concept Summary:</b> <i>Employee Fringe Benefits</i>	5-22
<b>GROSS INCOME: EXCLUSIONS</b>	<b>5-1</b>	<b>Global Tax Issues:</b> <i>Benefits of the Earned Income Exclusion Are Questioned</i>	5-22
<b>The Big Picture:</b> <i>Exclusions</i>	5-1	<b>INTEREST ON CERTAIN STATE AND LOCAL GOVERNMENT OBLIGATIONS</b>	<b>5-23</b>
<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	5-2	<b>EDUCATIONAL SAVINGS BONDS</b>	<b>5-24</b>
<b>INCOME EXCLUSIONS</b>	<b>5-2</b>	<b>EDUCATION SAVINGS PROGRAMS (§ 529 AND § 530 PLANS)</b>	<b>5-25</b>
Exclusion Defined	5-2	Qualified Tuition Program	5-26
Exclusions versus Non-Income Items	5-3	Coverdell Education Savings Account	5-26
<b>GIFTS AND INHERITANCES</b>	<b>5-3</b>	<b>QUALIFIED ABLE PROGRAMS (§ 529A PLANS)</b>	<b>5-26</b>
Legislative Intent	5-3	<b>INCOME FROM DISCHARGE OF INDEBTEDNESS</b>	<b>5-27</b>
Employer Payments to Employees	5-4	<b>TAX BENEFIT RULE</b>	<b>5-28</b>
Employee Death Benefits	5-4	<b>TAX PLANNING</b>	<b>5-30</b>
<b>LIFE INSURANCE PROCEEDS</b>	<b>5-5</b>	Life Insurance	5-30
General Rule	5-5	Employee Fringe Benefits	5-30
Accelerated Death Benefits	5-5	Investment Income	5-31
<b>Ethics &amp; Equity:</b> <i>Should the Terminally Ill Pay Social Security Taxes?</i>	5-6	<b>Refocus on the Big Picture:</b> <i>Exclusions</i>	5-32
Transfer for Valuable Consideration	5-6	<b>Part 3: Deductions and Credits</b>	
<b>SCHOLARSHIPS</b>	<b>5-7</b>	<b>CHAPTER 6</b>	
General Information	5-7	<b>DEDUCTIONS AND LOSSES: IN GENERAL</b>	<b>6-1</b>
Timing Issues	5-8	<b>The Big Picture:</b> <i>Calculation of Deductible Expenses</i>	6-1
<b>COMPENSATION FOR INJURIES AND SICKNESS</b>	<b>5-8</b>	<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	6-2
Damages	5-8		
<b>Ethics &amp; Equity:</b> <i>Tax Treatment of Damages Not Related to Physical Personal Injury</i>	5-9		
<b>Concept Summary:</b> <i>Taxation of Damages</i>	5-9		
<b>Ethics &amp; Equity:</b> <i>Classifying the Amount of the Claim</i>	5-10		

**CLASSIFICATION OF DEDUCTIBLE EXPENSES**

Classifying Deductions	6-3
Authority for Deductions	6-3
Deduction Criteria for § 162 and § 212	6-5
Personal Expenses	6-6
Business and Nonbusiness Losses	6-6
Deduction for Qualified Business Income	6-7
Reporting Procedures	6-9

**DEDUCTIONS AND LOSSES—TIMING OF EXPENSE RECOGNITION**

Importance of Taxpayer's Method of Accounting	6-10
Cash Method Requirements	6-10
Accrual Method Requirements	6-10
Prepaid Expenses—The "12-Month Rule"	6-12
Time Value of Tax Deductions	6-12

**DISALLOWANCE POSSIBILITIES**

Public Policy Limitation	6-13
<b>Global Tax Issues:</b> <i>Overseas Gun Sales Result in Large Fines</i>	6-14
<b>Ethics &amp; Equity:</b> <i>State Allowed Marijuana Activity: Do Regular Business Deduction Rules Apply (or Those for Drug Dealers)?</i>	6-15
Political Contributions and Lobbying Activities	6-15
Excessive Executive Compensation	6-16
Investigation of a Business	6-17
<b>Concept Summary:</b> <i>Costs of Investigating a Business</i>	6-18
Hobby Losses	6-18
<b>Concept Summary:</b> <i>Common Questions from the IRS Concerning Hobbies/Businesses with Losses</i>	6-20
Rental of Vacation Homes	6-21
<b>Concept Summary:</b> <i>Vacation/Rental Home</i>	6-22
Expenditures Incurred for Taxpayer's Benefit or Taxpayer's Obligation	6-25
Disallowance of Personal Expenditures	6-26
<b>Ethics &amp; Equity:</b> <i>Personal or Business Expenses?</i>	6-26
Disallowance of Deductions for Capital Expenditures	6-26
Transactions between Related Parties	6-28
Substantiation Requirements	6-29
Expenses and Interest Relating to Tax-Exempt Income	6-29
Other Disallowances	6-30

**TAX PLANNING**

Vacation Homes	6-30
<b>Concept Summary:</b> <i>Classification of Expenses</i>	6-31
Hobby Losses	6-32
Do Deduction Limits Affect Executive Compensation?	6-33
<b>Refocus on the Big Picture:</b> <i>Calculation of Deductible Business Expenses and Tax Planning</i>	6-33

**CHAPTER 7****DEDUCTIONS AND LOSSES: CERTAIN BUSINESS EXPENSES AND LOSSES**

<b>The Big Picture:</b> <i>Losses</i>	7-1
<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	7-2

**6-2**

6-3
6-3
6-5
6-6
6-6
6-7
6-9

**6-10**

6-10
6-10
6-10
6-12
6-12

**6-13**

6-13
6-14
6-15
6-15
6-16
6-17
6-18
6-18

**6-20**

6-21
6-22
6-25
6-26
6-26
6-28
6-29
6-29
6-30

**6-30**

6-30
6-31
6-32
6-33
6-33

**7-1**

7-1
7-2

**BAD DEBTS**

Specific Charge-Off Method	7-3
<b>Concept Summary:</b> <i>The Tax Treatment of Bad Debts Using the Specific Charge-Off Method</i>	7-4
Business versus Nonbusiness Bad Debts	7-4
Loans between Related Parties	7-5
<b>Concept Summary:</b> <i>Bad Debt Deductions</i>	7-5

**WORTHLESS SECURITIES AND SMALL BUSINESS STOCK LOSSES**

Worthless Securities	7-6
Small Business Stock (§ 1244 Stock) Losses	7-6

**LOSSES OF INDIVIDUALS**

Events That Are Not Casualties	7-7
Theft Losses	7-8
When to Deduct Casualty Losses	7-8
Measuring the Amount of Loss	7-9
<b>Ethics &amp; Equity:</b> <i>Is Policy Cancellation an Escape Hatch?</i>	7-10
Personal Casualty Gains and Losses	7-12
<b>Concept Summary:</b> <i>Casualty Gains and Losses</i>	7-14
Statutory Framework for Deducting Losses of Individuals	7-14
<b>Concept Summary:</b> <i>Statutory Framework for Deducting Losses of Individuals</i>	7-15

**RESEARCH AND EXPERIMENTAL EXPENDITURES**

Expense Method	7-16
Deferral and Amortization Method	7-16

**EXCESS BUSINESS LOSSES**

Excess Business Loss Defined	7-17
Losses from Partnerships or S Corporations	7-18
Other Rules	7-19

**NET OPERATING LOSSES**

General Rules	7-20
Computation of the Net Operating Loss	7-20
<b>Concept Summary:</b> <i>Computation of Net Operating Loss</i>	7-21
Computation of Taxable Income for Year to Which Net Operating Loss Is Carried	7-23
Calculation of the Remaining Net Operating Loss	7-24

**TAX PLANNING**

Small Business Stock (§ 1244 Stock) Losses	7-25
Casualty Losses	7-25
<b>Refocus on the Big Picture:</b> <i>Losses</i>	7-25

**CHAPTER 8****DEPRECIATION, COST RECOVERY, AMORTIZATION, AND DEPLETION**

<b>The Big Picture:</b> <i>Calculating Cost Recovery Deductions</i>	8-1
<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	8-2

**DEPRECIATION AND COST RECOVERY**

Nature of Property	8-2
--------------------	-----

Placed in Service Requirement	8-3	Computation of Automobile Expenses	9-6
Cost Recovery Allowed or Allowable	8-3		
Cost Recovery Basis for Personal Use Assets		<b>TRAVEL EXPENSES</b>	<b>9-9</b>
Converted to Business or Income-Producing Use	8-4	Definition of Travel Expenses	9-9
		Away-from-Home Requirement	9-10
		Restrictions on Travel Expenses	9-11
		Combined Business and Pleasure Travel	9-12
<b>MODIFIED ACCELERATED COST RECOVERY SYSTEM (MACRS): GENERAL RULES</b>	<b>8-4</b>		
<b>Concept Summary:</b> <i>MACRS: Class Lives, Methods, and Conventions</i>	8-4	<b>EDUCATION EXPENSES</b>	<b>9-14</b>
Personalty (and Certain Realty): Recovery Periods and Methods	8-5	General Requirements	9-14
<b>Financial Disclosure Insights:</b> <i>Tax and Book Depreciation</i>	8-6	Legal Requirements to Keep a Job	9-14
<b>Concept Summary:</b> <i>Straight-Line Cost Recovery under MACRS (Personalty vs. Realty)</i>	8-9	Maintaining or Improving Existing Skills	9-15
Realty: Recovery Periods and Methods	8-9	<b>Concept Summary:</b> <i>Conditions for Deducting Regular Education Expenses</i>	9-15
		What Expenses Are Allowed?	9-15
		Other Provisions Dealing with Education	9-16
		<b>Concept Summary:</b> <i>Tax Consequences of Provisions Dealing with Education</i>	9-16
<b>MODIFIED ACCELERATED COST RECOVERY SYSTEM (MACRS): SPECIAL RULES</b>	<b>8-10</b>		
Election to Expense Assets (§ 179)	8-10	<b>OTHER BUSINESS EXPENSES</b>	<b>9-17</b>
<b>Ethics &amp; Equity:</b> <i>Section 179 Limitation</i>	8-14	Office in the Home	9-17
Additional First-Year Depreciation (Bonus Depreciation)	8-14	Moving Expenses	9-21
Using § 179 and Bonus Depreciation Effectively	8-15	Entertainment and Meal Expenses	9-21
<b>Concept Summary:</b> <i>Using § 179 and Bonus Depreciation in 2021</i>	8-17	<b>Ethics &amp; Equity:</b> <i>Your Turn or Mine?</i>	9-23
Business and Personal Use of Automobiles and Other Listed Property	8-18	Miscellaneous Employee Expenses	9-24
Alternative Depreciation System (ADS)	8-23		
		<b>CONTRIBUTIONS TO RETIREMENT ACCOUNTS</b>	<b>9-25</b>
<b>REPORTING PROCEDURES</b>	<b>8-24</b>	\$ 401(k) Plans	9-25
<b>AMORTIZATION</b>	<b>8-25</b>	<b>INDIVIDUAL RETIREMENT ACCOUNTS (IRAS)</b>	<b>9-26</b>
		General Rules	9-26
<b>DEPLETION</b>	<b>8-28</b>	Taxation of Benefits	9-29
Intangible Drilling and Development Costs (IDCs)	8-29	Rollovers and Conversions	9-30
Depletion Methods	8-29	<b>Concept Summary:</b> <i>Comparison of IRAs</i>	9-30
<b>TAX PLANNING</b>	<b>8-31</b>	<b>RETIREMENT PLANS FOR SELF-EMPLOYED INDIVIDUALS</b>	<b>9-31</b>
Cost Recovery	8-31	Keogh (H.R. 10) Plans	9-31
Amortization	8-32	Solo § 401(k) Plans	9-31
Cost Recovery Tables	8-32	Savings Incentive Match Plan for Employees (SIMPLE Plans)	9-32
<b>Refocus on the Big Picture:</b> <i>Calculating Cost Recovery Deductions</i>	8-36	Simplified Employee Pension Plans (SEPs)	9-32
<b>CHAPTER 9</b>		<b>CLASSIFICATION OF EMPLOYEE EXPENSES</b>	<b>9-33</b>
<b>DEDUCTIONS: EMPLOYEE AND SELF-EMPLOYED-RELATED EXPENSES</b>	<b>9-1</b>	Accountable Plans	9-33
<b>The Big Picture:</b> <i>The First Job</i>	9-1	Nonaccountable Plans	9-34
<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	9-2		
		<b>LIMITATIONS ON ITEMIZED DEDUCTIONS</b>	<b>9-35</b>
<b>EMPLOYEE VERSUS INDEPENDENT CONTRACTOR</b>	<b>9-2</b>	Miscellaneous Itemized Deductions Subject to the 2%-of-AGI Floor	9-35
<b>Concept Summary:</b> <i>Employee versus Independent Contractor</i>	9-4	Miscellaneous Itemized Deductions Not Subject to the 2%-of-AGI Floor	9-35
<b>SELF-EMPLOYED AND EMPLOYEE-RELATED EXPENSES—IN GENERAL</b>	<b>9-5</b>	<b>TAX PLANNING</b>	<b>9-36</b>
		Employment Status	9-36
<b>TRANSPORTATION EXPENSES</b>	<b>9-5</b>	Implications of Misclassifying Workers	9-36
Qualified Expenses	9-5	Transportation and Travel Expenses	9-37
		<b>Refocus on the Big Picture:</b> <i>The First Job</i>	9-38



## CHAPTER 10 DEDUCTIONS AND LOSSES: CERTAIN ITEMIZED DEDUCTIONS

<b>The Big Picture:</b> <i>Impact of Itemized Deductions on Major Purchases</i>	10-1
<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	10-2

<b>MEDICAL EXPENSES</b>	<b>10-3</b>
Medical Expenses Defined	10-3
Capital Expenditures for Medical Purposes	10-4
Medical Expenses Incurred for Spouse and Dependents	10-5
Transportation, Meal, and Lodging Expenses for Medical Treatment	10-6
Amounts Paid for Medical Insurance Premiums	10-6
Year of Deduction	10-7
Reimbursements	10-7
Health Savings Accounts	10-8
Affordable Care Act Provisions	10-10

<b>TAXES</b>	<b>10-10</b>
Deductibility as a Tax	10-10
Property Taxes	10-11
State and Local Income Taxes and Sales Taxes	10-13

<b>INTEREST</b>	<b>10-14</b>
Allowed and Disallowed Items	10-14
Restrictions on Deductibility and Timing Considerations	10-17
Classification of Interest Expense	10-17
<b>Concept Summary:</b> <i>Deductibility of Personal, Student Loan, Mortgage, and Investment Interest</i>	10-18

<b>CHARITABLE CONTRIBUTIONS</b>	<b>10-18</b>
Criteria for a Gift	10-18
Qualified Organizations	10-20
<b>Ethics &amp; Equity:</b> <i>An Indirect Route to a Contribution Deduction</i>	10-20
Time of Deduction	10-20
Record-Keeping and Valuation Requirements	10-21
<b>Concept Summary:</b> <i>Documentation and Substantiation Requirements for Charitable Contributions</i>	10-21
<b>Global Tax Issues:</b> <i>Choose the Charity Wisely</i>	10-22
Limitations on Charitable Contribution Deduction	10-22
<b>Concept Summary:</b> <i>Determining the Deduction for Contributions by Individuals</i>	10-25

<b>TIMING OF PAYMENTS TO MAXIMIZE DEDUCTIONS</b>	<b>10-26</b>
--	--------------

<b>OTHER ITEMIZED DEDUCTIONS</b>	<b>10-27</b>
----------------------------------	--------------

<b>COMPREHENSIVE EXAMPLE OF SCHEDULE A</b>	<b>10-27</b>
--	--------------

<b>TAX PLANNING</b>	<b>10-29</b>
Maximizing the Medical Deduction	10-29
Ensuring the Charitable Contribution Deduction	10-29
Planning to Avoid Nondeductible Treatment	10-31
<b>Refocus on the Big Picture:</b> <i>Impact of Itemized Deductions on Major Purchases</i>	10-31

## CHAPTER 11 INVESTOR LOSSES

<b>The Big Picture:</b> <i>Investor Loss Limitations Affect the Viability of Certain Investment Opportunities</i>	11-1
<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	11-2

## THE TAX SHELTER PROBLEM

<b>AT-RISK LIMITS</b>	<b>11-4</b>
<b>Concept Summary:</b> <i>Calculation of At-Risk Amount</i>	11-5

<b>PASSIVE ACTIVITY LOSS LIMITS</b>	<b>11-5</b>
Classification and Tax Treatment of Passive Activity Income and Losses	11-5
Taxpayers Subject to the Passive Activity Loss Rules	11-9
Rules for Determining Passive Activities	11-10
<b>Concept Summary:</b> <i>Tests to Determine Material Participation</i>	11-14
Interaction of the At-Risk and Passive Activity Loss Limits	11-15
Special Passive Activity Rules for Real Estate Activities	11-16
<b>Concept Summary:</b> <i>Treatment of Losses Subject to the At-Risk and Passive Activity Loss Limitations</i>	11-17
<b>Ethics &amp; Equity:</b> <i>Punching the Time Clock at Year-End</i>	11-18
Dispositions of Passive Interests	11-20

<b>INVESTMENT INTEREST LIMITATION</b>	<b>11-21</b>
Limitation Imposed	11-21
<b>Concept Summary:</b> <i>Passive Activity Loss Rules: Key Issues and Answers</i>	11-22
Computation of Allowable Deduction	11-23

<b>OTHER INVESTMENT LOSSES</b>	<b>11-23</b>
<b>Concept Summary:</b> <i>Common Investment Loss Limitation Rules</i>	11-24

<b>TAX PLANNING</b>	<b>11-24</b>
Minimizing the Impact of Passive Activity Losses	11-24
Maximizing the Investment Interest Deduction	11-26
Effect of the Additional Tax on Net Investment Income	11-26
<b>Refocus on the Big Picture:</b> <i>Investor Loss Limitations Can Significantly Affect Investment Returns</i>	11-27

## CHAPTER 12 TAX CREDITS AND PAYMENTS

<b>The Big Picture:</b> <i>Education Tax Credits</i>	12-1
<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	12-2

## TAX POLICY CONSIDERATIONS

<b>TAX CREDITS</b>	<b>12-3</b>
Refundable versus Nonrefundable Credits	12-3
General Business Credit	12-5
Treatment of Unused General Business Credits	12-5

<b>SPECIFIC BUSINESS-RELATED TAX CREDITS</b>	<b>12-6</b>
Tax Credit for Rehabilitation Expenditures	12-6
<b>Ethics &amp; Equity:</b> <i>The Rehabilitation Tax Credit</i>	12-7
Work Opportunity Tax Credit	12-7

Credit for Increasing Research Activities	12-8	Gift Basis	13-12
Low-Income Housing Credit	12-9	Inherited Property	13-14
Disabled Access Credit	12-10	Disallowed Losses	13-16
Credit for Small Employer Pension Plan Startup Costs	12-10	<b>Concept Summary: Wash Sale Rules</b>	13-18
Credit for Employer-Provided Child Care	12-11	<b>Ethics &amp; Equity: Washing a Loss Using an IRA</b>	13-19
Credit for Employer-Provided Family and Medical Leave	12-11	Property Converted from Personal Use to Business or Income-Producing Use	13-19
<b>SPECIFIC TAX CREDITS FOR INDIVIDUALS</b>	<b>12-12</b>	Summary of Basis Adjustments	13-20
Earned Income Credit	12-12	<b>Concept Summary: Adjustments to Basis</b>	13-21
Child and Dependent Tax Credits	12-13	<b>NONTAXABLE EXCHANGES</b>	<b>13-22</b>
Credit for Child and Dependent Care Expenses	12-13	<b>LIKE-KIND EXCHANGES—§ 1031</b>	<b>13-22</b>
<b>Ethics &amp; Equity: Is This the Right Way to Use the Credit for Child and Dependent Care Expenses?</b>	12-15	Like-Kind Property	13-23
Education Tax Credits	12-15	Exchange Requirement	13-24
Credit for Certain Retirement Plan Contributions	12-17	<b>Concept Summary: Delayed § 1031 Exchange</b>	13-25
<b>TAX CREDITS AVAILABLE TO BUSINESSES AND INDIVIDUALS</b>	<b>12-17</b>	Boot	13-25
Foreign Tax Credit	12-17	Basis and Holding Period of Property Received	13-26
<b>Global Tax Issues: Sourcing Income in Cyberspace—Getting It Right When Calculating the Foreign Tax Credit</b>	12-18	Reporting Considerations	13-29
Energy Credits	12-19	<b>INVOLUNTARY CONVERSIONS—§ 1033</b>	<b>13-29</b>
<b>Concept Summary: Major Tax Credits</b>	12-20	Involuntary Conversion Defined	13-31
<b>TAX PAYMENTS</b>	<b>12-22</b>	Computing the Amount Realized	13-31
Payments by Employers	12-22	Replacement Property	13-32
Payments by Self-Employed Persons	12-23	<b>Concept Summary: Involuntary Conversions: Replacement Property Tests</b>	13-33
Affordable Care Act Provisions	12-24	Time Limitation on Replacement	13-33
Alternative Minimum Tax	12-26	Nonrecognition of Gain	13-34
<b>TAX PLANNING</b>	<b>12-28</b>	Reporting Considerations	13-35
Credit for Child and Dependent Care Expenses	12-28	<b>SALE OF A RESIDENCE—§ 121</b>	<b>13-35</b>
Energy Credits	12-28	Principal Residence	13-36
<b>Refocus on the Big Picture: Education Tax Credits</b>	12-28	Requirements for Exclusion Treatment	13-36
		Calculating the Exclusion	13-38
		Exceptions to the Two-Year Rules	13-39

## Part 4: Property Transactions

### CHAPTER 13 PROPERTY TRANSACTIONS: DETERMINATION OF GAIN OR LOSS, BASIS CONSIDERATIONS, AND NONTAXABLE EXCHANGES 13-1

**The Big Picture: Sale or Gift of Inherited House and Other Property Transactions** 13-1  
**Framework 1040: Tax Formula for Individuals** 13-2

**DETERMINATION OF GAIN OR LOSS** 13-2  
Realized Gain or Loss 13-3  
**Concept Summary: Realized Gain or Loss** 13-3  
Recognized Gain or Loss 13-8  
**Concept Summary: Realized and Recognized Gain or Loss** 13-8  
Nonrecognition of Gain or Loss 13-8

**BASIS CONSIDERATIONS** 13-9  
Determination of Cost Basis 13-9

**TAX PLANNING** 13-41  
Cost Identification and Documentation Considerations 13-41  
Selection of Property for Making Gifts 13-41  
Selection of Property to Pass at Death 13-42  
Disallowed Losses 13-42  
Like-Kind Exchanges 13-43  
Involuntary Conversions 13-43  
Sale of a Principal Residence 13-44  
**Refocus on the Big Picture: Sale or Gift of Inherited House and Other Property Transactions** 13-45

### CHAPTER 14 PROPERTY TRANSACTIONS: CAPITAL GAINS AND LOSSES, § 1231, AND RECAPTURE PROVISIONS 14-1

**The Big Picture: Managing Capital Asset Transactions** 14-1  
**Framework 1040: Tax Formula for Individuals** 14-2

**GENERAL SCHEME OF TAXATION** 14-3

<b>CAPITAL ASSETS</b>	<b>14-3</b>	Section 1250 Recapture Situations	14-39
Definition of a Capital Asset (§ 1221)	14-4	<b>Concept Summary:</b> <i>Comparison of § 1245 and § 1250 Depreciation Recapture</i>	14-39
<b>Ethics &amp; Equity:</b> <i>Sculpture as a Capital Asset</i>	14-6	Unrecaptured § 1250 Gain (Real Estate 25% Gain)	14-39
Effect of Judicial Action	14-6	<b>Ethics &amp; Equity:</b> <i>The Sale of a "Cost-Segregated" Building</i>	14-41
Statutory Expansions	14-7		
 <b>SALE OR EXCHANGE</b>	 <b>14-8</b>	 <b>CONSIDERATIONS COMMON TO §§ 1245 AND 1250</b>	 <b>14-41</b>
Worthless Securities and § 1244 Stock	14-8	Exceptions	14-41
Retirement of Corporate Obligations	14-9	<b>Global Tax Issues:</b> <i>Depreciation Recapture in Other Countries</i>	14-42
Options	14-9	Other Applications	14-43
<b>Concept Summary:</b> <i>Options: Consequences to the Grantor and Grantee</i>	14-11	<b>Concept Summary:</b> <i>Depreciation Recapture and § 1231 Netting Procedure</i>	14-44
Patents	14-11		
Franchises, Trademarks, and Trade Names (§ 1253)	14-12	 <b>SPECIAL RECAPTURE PROVISIONS</b>	 <b>14-44</b>
<b>Concept Summary:</b> <i>Franchises: Consequences to the Franchisor and Franchisee</i>	14-14	Special Recapture for Corporations	14-44
Lease Cancellation Payments	14-14	Gain from Sale of Depreciable Property between Certain Related Parties	14-45
		Intangible Drilling Costs	14-45
 <b>HOLDING PERIOD</b>	 <b>14-15</b>	 <b>REPORTING PROCEDURES</b>	 <b>14-45</b>
General Rules	14-15	<b>Ethics &amp; Equity:</b> <i>Incorrect Depreciation and Recognized Gain</i>	14-45
Special Holding Period Rules	14-15		
Special Rules for Short Sales	14-16	 <b>TAX PLANNING</b>	 <b>14-46</b>
<b>Concept Summary:</b> <i>Short Sales of Securities</i>	14-18	Importance of Capital Asset Status	14-46
		Planning for Capital Asset Status	14-46
 <b>TAX TREATMENT OF CAPITAL GAINS AND LOSSES OF NONCORPORATE TAXPAYERS</b>	 <b>14-19</b>	<b>Global Tax Issues:</b> <i>Capital Gain Treatment in the United States and Other Countries</i>	14-47
Capital Gain and Loss Netting Process	14-19	Effect of Capital Asset Status in Transactions Other Than Sales	14-47
Qualified Dividend Income	14-22	Stock Sales	14-48
Alternative Tax on Net Capital Gain and Qualified Dividend Income	14-22	Maximizing Benefits	14-48
<b>Concept Summary:</b> <i>Income Layers for Alternative Tax on Capital Gain Computation</i>	14-24	Year-End Planning	14-48
Treatment of Net Capital Losses	14-26	Timing of § 1231 Gain	14-48
<b>Concept Summary:</b> <i>Final Results of the Capital Gain and Loss Netting Process and How They Are Taxed</i>	14-27	Timing of Recapture	14-49
		Postponing and Shifting Recapture	14-49
 <b>TAX TREATMENT OF CAPITAL GAINS AND LOSSES OF CORPORATE TAXPAYERS</b>	 <b>14-27</b>	Avoiding Recapture	14-50
		<b>Refocus on the Big Picture:</b> <i>Managing Capital Asset Transactions</i>	14-50
 <b>OVERVIEW OF § 1231 AND THE RECAPTURE PROVISIONS</b>	 <b>14-28</b>		
 <b>SECTION 1231 ASSETS</b>	 <b>14-28</b>	 <b>Part 5: Special Tax Computations and Accounting Periods and Methods</b>	
Relationship to Capital Assets	14-28		
Property Included	14-29	 <b>CHAPTER 15</b>	
Property Excluded	14-30	<b>THE DEDUCTION FOR QUALIFIED BUSINESS INCOME FOR NONCORPORATE TAXPAYERS</b>	<b>15-1</b>
Section 1231 Assets Disposed of by Casualty or Theft	14-30	<b>The Big Picture:</b> <i>Entrepreneurial Pursuits</i>	15-1
<b>Concept Summary:</b> <i>Section 1231 Netting Procedure (Discussed in Text Section 14-8e)</i>	14-31		
General Procedure for § 1231 Computation	14-32	 <b>TAX TREATMENT OF VARIOUS BUSINESS FORMS</b>	 <b>15-2</b>
		Sole Proprietorships	15-2
 <b>SECTION 1245 RECAPTURE</b>	 <b>14-35</b>	Partnerships	15-3
Section 1245 Property	14-37		
Observations on § 1245	14-38		
 <b>SECTION 1250 RECAPTURE</b>	 <b>14-38</b>		

Corporations	15-3
<b>Concept Summary:</b> <i>Tax Treatment of Business Forms Compared</i>	15-6
<b>Global Tax Issues:</b> <i>U.S. Corporate Taxes and International Business Competitiveness</i>	15-7
Limited Liability Companies	15-7

## THE TAX CUTS AND JOBS ACT (TCJA) OF 2017 AND ENTITY TAX RATES 15-8

Challenges of Lowering Tax Rates	15-8
Lowering Tax Rates for Different Business Forms	15-9

## THE DEDUCTION FOR QUALIFIED BUSINESS INCOME 15-10

General Rule	15-10
The Overall Limitation: Modified Taxable Income	15-10
Definition of Qualified Business Income	15-11
Definition of a Qualified Trade or Business	15-11
Limitations on the QBI Deduction	15-13
Limitation Based on Wages and Capital Investment	15-14
<b>Concept Summary:</b> <i>An Overview of the 2021 Qualified Business Income Deduction</i>	15-15
Limitation for "Specified Services" Businesses	15-18
Reporting the Qualified Business Income Deduction	15-26
Aggregation of Qualified Trades and Businesses Under the § 199A Regulations	15-27
Treatment of Losses	15-32
Coordination with Other Rules	15-34
Considerations for Partnerships and S Corporations	15-35
Other Items in the § 199A Regulations	15-35

## TAX PLANNING 15-36

Corporate versus Noncorporate Forms of Business Organization	15-36
Optimizing the Deduction for Qualified Business Income	15-37
<b>Refocus on the Big Picture:</b> <i>Entrepreneurial Pursuits</i>	15-37

## CHAPTER 16 ACCOUNTING PERIODS AND METHODS 16-1

<b>The Big Picture:</b> <i>Accounting Period and Method</i>	16-1
<b>Framework 1040:</b> <i>Tax Formula for Individuals</i>	16-2

### ACCOUNTING PERIODS 16-2

Specific Provisions for Partnerships, S Corporations, and Personal Service Corporations	16-3
<b>Ethics &amp; Equity:</b> <i>Who Benefits from the Change in Tax Year?</i>	16-5
Selecting the Tax Year	16-6
Changes in the Accounting Period	16-6
Taxable Periods of Less Than One Year	16-7
Mitigation of the Annual Accounting Period Concept	16-8
<b>Ethics &amp; Equity:</b> <i>Special Tax Relief</i>	16-10

### ACCOUNTING METHODS 16-10

Permissible Methods	16-10
Cash Receipts and Disbursements Method	16-11
Accrual Method	16-13
<b>Concept Summary:</b> <i>Accruals Under the Economic Performance Test</i>	16-14

<b>Financial Disclosure Insights:</b> <i>Tax Deferrals from Reserves</i>	16-16
Hybrid Method	16-16
Change of Method	16-17
<b>Ethics &amp; Equity:</b> <i>Change in Accounting Method</i>	16-19

## SPECIAL ACCOUNTING METHODS 16-19

Installment Method	16-19
<b>Concept Summary:</b> <i>Interest on Installment Sales</i>	16-24
Long-Term Contracts	16-27

## INVENTORIES 16-30

Determining Inventory Cost	16-31
<b>Ethics &amp; Equity:</b> <i>Preserving the LIFO Reserve</i>	16-35
The LIFO Election	16-35
Special Inventory Methods Relating to Farming and Ranching	16-36
Inventory of Small Taxpayers	16-36

## TAX PLANNING 16-37

Taxable Year	16-37
Cash Method of Accounting	16-37
Installment Method	16-37
Inventories	16-38
<b>Refocus on the Big Picture:</b> <i>Accounting Period and Method</i>	16-38

# Part 6: Corporations

## CHAPTER 17 CORPORATIONS: INTRODUCTION AND OPERATING RULES 17-1

<b>The Big Picture:</b> <i>A Half-Baked Idea?</i>	17-1
---	------

## AN INTRODUCTION TO THE INCOME TAXATION OF CORPORATIONS 17-2

An Overview of Corporate versus Individual Income Tax Treatment	17-2
Specific Provisions Compared	17-3
Accounting Periods and Methods	17-4
Capital Gains and Losses	17-5
Recapture of Depreciation	17-6
Business Interest Expense Limitation	17-6
Passive Activity Losses	17-8
<b>Concept Summary:</b> <i>Special Rules Applicable to Personal Service Corporations (PSCs)</i>	17-9
Charitable Contributions	17-9
Excessive Executive Compensation	17-11
Net Operating Losses	17-12
Deductions Available Only to Corporations	17-12
<b>Ethics &amp; Equity:</b> <i>Pushing the Envelope on Year-End Planning</i>	17-15
<b>Concept Summary:</b> <i>Income Taxation of Individuals and Corporations Compared</i>	17-17



<b>DETERMINING THE CORPORATE INCOME TAX LIABILITY</b>	<b>17-18</b>	<b>INVESTOR LOSSES</b>	<b>18-21</b>
Corporate Income Tax Rates	17-18	Stock and Security Losses	18-21
Alternative Minimum Tax	17-19	Business versus Nonbusiness Bad Debts	18-21
Restrictions on Corporate Accumulations	17-19	<b>Ethics &amp; Equity:</b> <i>Can a Loss Produce a Double Benefit?</i>	18-21
Consolidated Returns	17-20	Section 1244 Stock	18-23
<b>Financial Disclosure Insights:</b> <i>GAAP and Tax Treatment of Consolidations</i>	17-22	<b>GAIN FROM QUALIFIED SMALL BUSINESS STOCK</b>	<b>18-24</b>
<b>PROCEDURAL MATTERS</b>	<b>17-23</b>	<b>TAX PLANNING</b>	<b>18-24</b>
Filing Requirements for Corporations	17-23	Working with § 351	18-24
Estimated Tax Payments	17-24	Selecting Assets to Transfer	18-26
Schedule M-1—Reconciliation of Income (Loss) per Books with Income per Return	17-24	Debt in the Capital Structure	18-26
Schedule M-2—Analysis of Unappropriated Retained Earnings per Books	17-25	Investor Losses	18-27
<b>Concept Summary:</b> <i>Conceptual Diagram of Schedule M-1 (Form 1120)</i>	17-26	Corporations versus Flow-Through Entities	18-28
Schedule M-3—Net Income (Loss) Reconciliation for Corporations with Total Assets of \$10 Million or More	17-26	<b>Refocus on the Big Picture:</b> <i>The Vehicle for Business Growth Is the Corporate Form</i>	18-29
Income Taxes in the Financial Statements	17-28	<b>CHAPTER 19</b>	
<b>TAX PLANNING</b>	<b>17-34</b>	<b>CORPORATIONS: DISTRIBUTIONS NOT IN COMPLETE LIQUIDATION</b>	<b>19-1</b>
Corporate versus Noncorporate Forms of Business Organization	17-34	<b>The Big Picture:</b> <i>Taxing Corporate Distributions</i>	19-1
Operating the Corporation	17-35	<b>CORPORATE DISTRIBUTIONS—OVERVIEW</b>	<b>19-2</b>
<b>Refocus on the Big Picture:</b> <i>Cooked to Perfection</i>	17-37	<b>EARNINGS AND PROFITS (E &amp; P)</b>	<b>19-3</b>
<b>CHAPTER 18</b>		Computation of E & P	19-3
<b>CORPORATIONS: ORGANIZATION AND CAPITAL STRUCTURE</b>	<b>18-1</b>	Summary of E & P Adjustments	19-6
<b>The Big Picture:</b> <i>The Vehicle for Business Growth Is the Corporate Form</i>	18-1	<b>Concept Summary:</b> <i>E &amp; P Adjustments</i>	19-7
<b>ORGANIZATION OF AND TRANSFERS TO CONTROLLED CORPORATIONS</b>	<b>18-2</b>	Current versus Accumulated E & P	19-8
Section 351 Rationale and General Rules	18-2	Allocating E & P to Distributions	19-8
<b>Global Tax Issues:</b> <i>Tax Reform Adds a New Wrinkle to the Choice of Organizational Form When Operating Overseas</i>	18-3	<b>Concept Summary:</b> <i>Allocating E &amp; P to Distributions</i>	19-9
<b>Concept Summary:</b> <i>Shareholder Consequences: Taxable Corporate Formation versus Tax-Deferred § 351 Transaction</i>	18-5	<b>Ethics &amp; Equity:</b> <i>Shifting E &amp; P</i>	19-12
Property Defined	18-5	<b>DIVIDENDS</b>	<b>19-12</b>
Stock Transferred	18-6	Rationale for Reduced Tax Rates on Dividends	19-12
Control of the Corporation	18-6	Qualified Dividends	19-13
Basis Determination and Related Issues	18-10	Property Dividends	19-14
<b>Concept Summary:</b> <i>Tax Consequences to the Shareholders and Corporation: With and Without the Application of § 351 (Based on the Facts of Example 16)</i>	18-11	<b>Concept Summary:</b> <i>Noncash Property Distributions</i>	19-16
Assumption of Liabilities—§ 357	18-14	Constructive Dividends	19-16
<b>Concept Summary:</b> <i>Tax Consequences of Liability Assumption</i>	18-17	Stock Dividends and Stock Rights	19-19
<b>CAPITAL STRUCTURE OF A CORPORATION</b>	<b>18-18</b>	<b>STOCK REDEMPTIONS</b>	<b>19-21</b>
Capital Contributions	18-18	Overview	19-21
Debt in the Capital Structure	18-18	<b>Global Tax Issues:</b> <i>Foreign Shareholders Prefer Sale or Exchange Treatment in Stock Redemptions</i>	19-23
		Historical Background	19-24
		<b>Concept Summary:</b> <i>Summary of the Qualifying Stock Redemption Rules</i>	19-24
		Stock Attribution Rules	19-25
		<b>Concept Summary:</b> <i>Tax Consequences of Stock Redemptions to Shareholders</i>	19-26
		Not Essentially Equivalent Redemptions	19-26
		Disproportionate Redemptions	19-27

Complete Termination Redemptions	19-28
Redemptions to Pay Death Taxes	19-28
<b>STOCK REDEMPTIONS—EFFECT ON THE CORPORATION</b>	<b>19-29</b>
Recognition of Gain or Loss	19-29
Effect on Earnings and Profits	19-30
Redemption Expenditures	19-30
<b>OTHER CORPORATE DISTRIBUTIONS</b>	<b>19-30</b>
<b>TAX PLANNING</b>	<b>19-30</b>
Corporate Distributions	19-30
<b>Concept Summary:</b> <i>Corporate Distributions</i>	19-31
Planning for Qualified Dividends	19-32
Constructive Dividends	19-33
Stock Redemptions	19-33
<b>Refocus on the Big Picture:</b> <i>Taxing Corporate Distributions</i>	19-34

<b>CHAPTER 20</b>	
<b>CORPORATIONS: DISTRIBUTIONS IN COMPLETE LIQUIDATION AND AN OVERVIEW OF REORGANIZATIONS</b>	<b>20-1</b>
<b>The Big Picture:</b> <i>The Options for Transitioning to Retirement</i>	20-1

<b>LIQUIDATIONS—IN GENERAL</b>	<b>20-2</b>
The Liquidation Process	20-2
Liquidating and Nonliquidating Distributions Compared	20-2

<b>LIQUIDATIONS—EFFECT ON THE DISTRIBUTING CORPORATION</b>	<b>20-3</b>
The General Rule	20-3
Antistuffing Rules	20-4
<b>Concept Summary:</b> <i>Summary of Antistuffing Loss Disallowance Rules</i>	20-8

<b>LIQUIDATIONS—EFFECT ON THE SHAREHOLDER</b>	<b>20-8</b>
<b>Ethics &amp; Equity:</b> <i>Transferee Liability for Tax Deficiency of Liquidated Corporation</i>	20-9

<b>LIQUIDATIONS—PARENT-SUBSIDIARY SITUATIONS</b>	<b>20-9</b>
Minority Shareholder Interests	20-10
Indebtedness of the Subsidiary to the Parent	20-10
<b>Global Tax Issues:</b> <i>Basis Rules for Liquidations of Foreign Subsidiaries</i>	20-11
Basis of Property Received by the Parent Corporation—The General Rule	20-11
Basis of Property Received by the Parent Corporation—§ 338 Election	20-12
<b>Concept Summary:</b> <i>Summary of Liquidation Rules</i>	20-13

<b>CORPORATE REORGANIZATIONS</b>	<b>20-14</b>
In General	20-15
Different Types of Reorganizations	20-15

Tax Consequences in a Tax-Free Reorganization	20-15
<b>Financial Disclosure Insights:</b> <i>Acquisitions Can Have Negative Consequences</i>	20-16
<b>Concept Summary:</b> <i>Gain and Basis Rules for Nontaxable Exchanges</i>	20-16
<b>Concept Summary:</b> <i>Basis to Acquiring Corporation of Property Received</i>	20-18
<b>TAX PLANNING</b>	<b>20-19</b>
Effect of a Liquidating Distribution on the Corporation	20-19
Effect of a Liquidating Distribution on the Shareholder	20-19
Parent-Subsidiary Liquidations	20-20
Asset Purchase versus Stock Purchase	20-20
<b>Refocus on the Big Picture:</b> <i>The Transition to Retirement Is Subject to Double Taxation</i>	20-21

## Part 7: Flow-Through Entities

<b>CHAPTER 21</b>	
<b>PARTNERSHIPS</b>	<b>21-1</b>
<b>The Big Picture:</b> <i>Why Use a Partnership, Anyway?</i>	21-1

<b>OVERVIEW OF PARTNERSHIP TAXATION</b>	<b>21-2</b>
What Is a Partnership?	21-2
<b>Concept Summary:</b> <i>Comparison of Partnership Types</i>	21-3
Key Concepts in Taxation of Partnership Income	21-4

<b>FORMATION OF A PARTNERSHIP: TAX EFFECTS</b>	<b>21-6</b>
Contributions to the Partnership	21-6
Exceptions to the General Rule of § 721	21-7
Other Issues Related to Contributed Property	21-9
<b>Concept Summary:</b> <i>Partnership Formation and Initial Basis Computations</i>	21-11
Tax Accounting Elections	21-11
Initial Costs of a Partnership	21-12
Method of Accounting	21-12
Taxable Year of the Partnership	21-13

<b>PARTNERSHIP OPERATIONS AND REPORTING</b>	<b>21-15</b>
Partnership Reporting, In General	21-15
Measuring Partnership Income	21-16
Form 1065 Example	21-18
<b>Financial Disclosure Insights:</b> <i>Financial Reporting for Partnerships</i>	21-24

<b>PARTNER CALCULATIONS AND REPORTING</b>	<b>21-24</b>
Partner Reporting of Partnership Income	21-24
Partner Allocations	21-26
Schedule K-1 Example	21-28
<b>Concept Summary:</b> <i>Tax Reporting of Partnership Items</i>	21-30
Partner's Basis	21-31
Effect of Partnership Liabilities on Partner's Basis	21-31
Partner's Capital Account	21-35
<b>Concept Summary:</b> <i>Comparing a Partner's Tax Basis and Capital Account</i>	21-36

Loss Limitations	21-36	<b>Concept Summary:</b> <i>Consequences of Noncash Distributions</i>	22-18
<b>Global Tax Issues:</b> <i>Withholding Requirements for non-U.S. Partners</i>	21-38	Shareholder's Basis in S Stock	22-19
<b>OTHER TAXES ON PARTNERSHIP INCOME</b>	<b>21-39</b>	Treatment of Losses	22-21
Self-Employment Tax	21-39	Tax on Pre-Election Built-In Gain	22-22
Net Investment Income Tax	21-40	LIFO Recapture Tax	22-23
		Passive Investment Income Penalty Tax	22-23
		Other Operational Rules	22-24
<b>DISTRIBUTIONS FROM THE PARTNERSHIP</b>	<b>21-40</b>	<b>TAX PLANNING</b>	<b>22-25</b>
Distributions in General	21-40	When the Election Is Advisable	22-25
Proportionate Current Distributions	21-41	<b>Concept Summary:</b> <i>Making an S Election</i>	22-25
Proportionate Liquidating Distributions	21-44	Making a Proper Election	22-26
<b>Concept Summary:</b> <i>Proportionate Current Distributions (General Rules)</i>	21-45	Operation of the S Corporation	22-26
<b>SALE OF A PARTNERSHIP INTEREST</b>	<b>21-47</b>	<b>OVERALL COMPARISON OF FORMS OF DOING BUSINESS</b>	<b>22-27</b>
General Rules	21-47	<b>Concept Summary:</b> <i>Tax Attributes of Different Forms of Business (Assume That Partners and Shareholders Are All Individuals)</i>	22-28
Hot Assets and Carried Interests	21-48	<b>Refocus on the Big Picture:</b> <i>Using a Pass-Through Entity to Achieve Deductibility of Losses</i>	22-31
<b>LIMITED LIABILITY ENTITIES</b>	<b>21-49</b>		
Limited Liability Companies	21-49		
Limited Liability Partnerships	21-50		
<b>TAX PLANNING</b>	<b>21-51</b>		
Choosing Partnership Taxation	21-51		
<b>Concept Summary:</b> <i>Major Advantages and Disadvantages of the Partnership Form</i>	21-52		
Formation and Operation of a Partnership	21-52		
Basis Considerations and Loss Deduction Limitations	21-52		
Transactions between Partners and Partnerships	21-52		
Drafting the Partnership Agreement	21-53		
<b>Refocus on the Big Picture:</b> <i>Why Use a Partnership, Anyway?</i>	21-53		
<b>CHAPTER 22</b>	<b>22-1</b>		
<b>S CORPORATIONS</b>			
<b>The Big Picture:</b> <i>Deductibility of Losses and the Choice of Business Entity</i>	22-1		
<b>CHOICE OF BUSINESS ENTITY</b>	<b>22-2</b>		
An Overview of S Corporations	22-2		
<b>QUALIFYING FOR S CORPORATION STATUS</b>	<b>22-3</b>		
Defining an S Corporation	22-3		
Making the Election	22-5		
Shareholder Consent	22-6		
Loss of the Election	22-7		
<b>OPERATIONAL RULES</b>	<b>22-9</b>		
Taxable Income	22-9		
Qualified Business Income Deduction	22-12		
Allocation of Income and Loss	22-12		
Distributions to Shareholders	22-13		
<b>Concept Summary:</b> <i>Classification Procedures for Distributions from an S Corporation</i>	22-14		
Noncash Property Distributions	22-18		
		<b>CHAPTER 23</b>	<b>23-1</b>
		<b>EXEMPT ENTITIES</b>	
		<b>The Big Picture:</b> <i>Effect of a For-Profit Business on a Tax-Exempt Entity</i>	23-1
		<b>TYPES OF EXEMPT ORGANIZATIONS</b>	<b>23-3</b>
		<b>CHARACTERISTICS OF EXEMPT ENTITIES</b>	<b>23-3</b>
		Serving the Common Good	23-3
		Not-for-Profit Entity	23-3
		Use of Net Earnings	23-3
		<b>Concept Summary:</b> <i>Consequences of Exempt Status</i>	23-5
		<b>TAXES ON EXEMPT ENTITIES</b>	<b>23-5</b>
		Taxable Transactions	23-5
		Feeder Organizations	23-8
		<b>PRIVATE FOUNDATIONS</b>	<b>23-8</b>
		Tax Consequences of Private Foundation Status	23-8
		<b>Concept Summary:</b> <i>Exempt Organizations: Classification</i>	23-10
		Taxes Imposed on Private Foundations	23-11
		<b>UNRELATED BUSINESS INCOME TAX</b>	<b>23-12</b>
		Unrelated Trade or Business	23-13
		Unrelated Business Taxable Income	23-16
		<b>Concept Summary:</b> <i>Unrelated Business Income Tax</i>	23-18
		<b>REPORTING REQUIREMENTS</b>	<b>23-19</b>
		Obtaining Exempt Organization Status	23-19
		Annual Filing Requirements	23-19

## Part 8: Advanced Tax Practice Considerations

Disclosure Requirements	23-20	Selecting the Optimal State in Which to Operate	24-28
<b>TAX PLANNING</b>	<b>23-21</b>	Restructuring Corporate Entities	24-29
Choosing an Exempt Classification	23-21	Subjecting the Corporation's Income to Apportionment	24-31
Maintaining Exempt Status	23-21	<b>Ethics &amp; Equity: Can You Be a Nowhere Adviser?</b>	24-32
Private Foundation	23-22	Planning with Apportionment Factors	24-32
Unrelated Business Income Tax	23-22	Sales/Use Tax Compliance	24-33
<b>Refocus on the Big Picture: Effect of a For-Profit Business on a Tax-Exempt Entity</b>	23-23	Capital Stock Taxation	24-33
		<b>Refocus on the Big Picture: Making a Multistate Location Decision</b>	24-33
<b>CHAPTER 24</b>		<b>CHAPTER 25</b>	
<b>MULTISTATE CORPORATE TAXATION</b>	<b>24-1</b>	<b>TAXATION OF INTERNATIONAL TRANSACTIONS</b>	<b>25-1</b>
<b>The Big Picture: Making a Multistate Location Decision</b>	24-1	<b>The Big Picture: Going International</b>	25-1
<b>CORPORATE STATE INCOME TAXATION</b>	<b>24-2</b>	<b>OVERVIEW OF INTERNATIONAL TAXATION</b>	<b>25-3</b>
Computing State Income Tax	24-2	<b>TAX TREATIES</b>	<b>25-5</b>
State Modifications	24-3	<b>Global Tax Issues: COVID-19 and Permanent Establishment</b>	25-6
The UDITPA and the Multistate Tax Commission	24-3	<b>SOURCING OF INCOME AND DEDUCTIONS</b>	<b>25-6</b>
Jurisdiction to Impose Tax:		Income Sourcing Rules	25-7
Nexus and Public Law 86-272	24-6	Allocation and Apportionment of Deductions	25-9
Nexus in Today's Economy	24-7	<b>Concept Summary: The Sourcing Rules</b>	25-10
<b>Concept Summary: Multistate Taxation</b>	24-8	Transfer Pricing	25-10
<b>APPORTIONMENT AND ALLOCATION OF INCOME</b>	<b>24-8</b>	<b>Ethics &amp; Equity: The Costs of Good Tax Planning</b>	25-11
The Apportionment Procedure	24-9	<b>FOREIGN CURRENCY GAIN/LOSS</b>	<b>25-14</b>
Apportionable Income	24-9	<b>U.S. PERSONS WITH OFFSHORE INCOME</b>	<b>25-15</b>
Apportionment Factors: Elements and Planning	24-11	Export Property, Licenses, Foreign Branches	25-15
<b>Concept Summary: Apportionable Income</b>	24-12	<b>Financial Disclosure Insights: Overseas Operations and Book-Tax Differences</b>	25-17
The Sales Factor	24-13	<b>Concept Summary: The Foreign Tax Credit</b>	25-17
The Payroll Factor	24-14	Tax Havens	25-18
The Property Factor	24-16	Offshore (Foreign) Corporations Controlled by U.S. Persons	25-19
<b>Financial Disclosure Insights: State/Local Taxes and the Tax Expense</b>	24-17	<b>Concept Summary: Subpart F Income and a CFC</b>	25-21
<b>THE UNITARY THEORY</b>	<b>24-18</b>	<b>Concept Summary: Components of Subpart F Income</b>	25-23
What Is a Unitary Business?	24-19	Movement Toward a More Territorial System	25-23
Tax Effects of the Unitary Theory	24-19	<b>U.S. TAXATION OF NONRESIDENT ALIENS AND FOREIGN CORPORATIONS</b>	<b>25-25</b>
Consolidated and Combined Returns	24-21	Nonresident Alien Individuals	25-25
<b>Global Tax Issues: Water's Edge Is Not a Day at the Beach</b>	24-21	Foreign Corporations	25-27
<b>Concept Summary: Using Apportionment Formulas</b>	24-22	Foreign Investment in Real Property Tax Act	25-28
<b>TAXATION OF S CORPORATIONS</b>	<b>24-22</b>	Expatriation to Avoid U.S. Taxation	25-28
Eligibility	24-22	<b>REPORTING REQUIREMENTS</b>	<b>25-29</b>
State Tax Filing Requirements	24-22	<b>TAX PLANNING</b>	<b>25-29</b>
<b>TAXATION OF PARTNERSHIPS AND LLCs</b>	<b>24-23</b>	The Foreign Tax Credit Limitation and Sourcing Provisions	25-29
<b>OTHER STATE AND LOCAL TAXES</b>	<b>24-23</b>	Transfer Pricing	25-30
State and Local Sales and Use Taxes	24-23	<b>Refocus on the Big Picture: Going International</b>	25-31
Local Property Taxes	24-25		
Other Taxes	24-26		
<b>Ethics &amp; Equity: Encouraging Economic Development through Tax Concessions</b>	24-27		
<b>TAX PLANNING</b>	<b>24-28</b>		

## CHAPTER 26 TAX PRACTICE AND ETHICS

**The Big Picture:** *A Tax Adviser's Dilemma*

### TAX ADMINISTRATION

Organizational Structure of the IRS	26-3
IRS Procedure—Letter Rulings	26-4
IRS Procedure—Other Issuances	26-4
<b>Ethics &amp; Equity:</b> <i>Tax Compliance Costs</i>	26-5
Administrative Powers of the IRS	26-5
The Audit Process	26-6
<b>Ethics &amp; Equity:</b> <i>Can the IRS Pretend to Be Your Friend?</i>	26-7
The Taxpayer Appeal Process	26-9
Offers in Compromise and Closing Agreements	26-10
<b>Ethics &amp; Equity:</b> <i>Our Taxing System of Self-Assessment</i>	26-11
Interest	26-12
<b>Concept Summary:</b> <i>Working with the IRS</i>	26-13
Taxpayer Penalties	26-13
<b>Ethics &amp; Equity:</b> <i>First-Time Tax Violators Can Get Off with Just a Warning</i>	26-18
Statute of Limitations	26-21

### THE TAX PROFESSION AND TAX ETHICS

The Tax Professional	26-22
Regulating Tax Preparers	26-23
IRS Rules Governing Tax Practice	26-23
Preparer Penalties	26-24
Privileged Communications	26-26
AICPA Statements on Standards for Tax Services	26-27
<b>Concept Summary:</b> <i>Tax Profession and Ethics</i>	26-30

### TAX PLANNING

Strategies in Seeking a Letter Ruling	26-30
Considerations in Handling an IRS Audit	26-30
Statute of Limitations	26-31
Litigation Considerations	26-32
Penalties	26-32
Ethics in the Tax Practice	26-32
Privileged Communications	26-33
<b>Refocus on the Big Picture:</b> <i>A Tax Adviser's Dilemma</i>	26-33

## Part 9: Family Tax Planning

## CHAPTER 27 THE FEDERAL GIFT AND ESTATE TAXES

**The Big Picture:** *An Eventful and Final Year*

### TRANSFER TAXES—IN GENERAL

Nature of the Taxes	27-2
<b>Global Tax Issues:</b> <i>U.S. Transfer Taxes and NRAs</i>	27-3
<b>Concept Summary:</b> <i>Gift Tax Formula</i>	27-3
<b>Concept Summary:</b> <i>Estate Tax Formula</i>	27-4
Valuation Issues	27-5
Key Property Concepts	27-6

### THE FEDERAL GIFT TAX

General Considerations	27-7
<b>Ethics &amp; Equity:</b> <i>It's the Thought That Counts</i>	27-7
Transfers Subject to the Gift Tax	27-9
Annual Gift Tax Exclusion	27-10
Deductions	27-11
Computing the Federal Gift Tax	27-11
Procedural Matters	27-12
<b>Concept Summary:</b> <i>Federal Gift Tax Provisions</i>	27-13

### THE FEDERAL ESTATE TAX

Gross Estate	27-13
<b>Concept Summary:</b> <i>Federal Estate Tax Provisions—Gross Estate</i>	27-18
Taxable Estate	27-19
Estate Tax Credits	27-22
<b>Global Tax Issues:</b> <i>Treaty Relief Is Not Abundant!</i>	27-23
Procedural Matters	27-23
<b>Concept Summary:</b> <i>Federal Estate Tax Provisions—Taxable Estate and Procedural Matters</i>	27-24

### THE GENERATION-SKIPPING TRANSFER TAX

Inter-Generational Transfers	27-24
The Tax on Generation-Skipping Transfers	27-24

### TAX PLANNING

The Federal Gift Tax	27-25
The Federal Estate Tax	27-26
<b>Refocus on the Big Picture:</b> <i>An Eventful and Final Year</i>	27-28

## CHAPTER 28 INCOME TAXATION OF TRUSTS AND ESTATES

**The Big Picture:** *Setting Up a Trust to Protect a Family*

### FIDUCIARY INCOME TAXATION

What Is a Trust?	28-2
What Is an Estate?	28-5

### NATURE OF TRUST AND ESTATE TAXATION

<b>Concept Summary:</b> <i>Tax Characteristics of Major Pass-Through Entities</i>	28-6
Tax Accounting Periods and Methods	28-6
Tax Rates and Personal Exemption	28-6
Alternative Minimum Tax	28-7
Additional Tax on Net Investment Income	28-8

### TAXABLE INCOME OF TRUSTS AND ESTATES

Entity Accounting Income	28-8
Gross Income	28-11
<b>Ethics &amp; Equity:</b> <i>To Whom Can I Trust My Pet?</i>	28-13
Ordinary Deductions	28-13
Deductions for Losses	28-15
Charitable Contributions	28-15
Deduction for Distributions to Beneficiaries	28-16
<b>Concept Summary:</b> <i>Uses of the DNI Amount</i>	28-17
Tax Credits	28-19



**Concept Summary:** *Principles of Fiduciary Income Taxation*

28-20

**TAXATION OF BENEFICIARIES**

**28-20**

Distributions by Simple Trusts

28-20

Distributions by Estates and Complex Trusts

28-20

Character of Income

28-22

**GRANTOR TRUSTS**

**28-23**

**PROCEDURAL MATTERS**

**28-25**

**TAX PLANNING**

**28-25**

A Trust or an Estate as an Income-Shifting Device

28-25

Income Tax Planning for Estates

28-26

Distributions of In-Kind Property

28-27

**Ethics & Equity:** *Who Should Be a Trustee?*

28-27

Deductibility of Administrative Expenses

28-27

Duties of an Executor

28-28

Additional Taxes on Capital Gains and Net Investment Income

28-28

**Refocus on the Big Picture:** *Setting Up a Trust to Protect a Family*

28-29

TABLE OF CODE SECTIONS CITED

D-1

PRESENT VALUE AND FUTURE VALUE TABLES

E-1

PRACTICE SET ASSIGNMENTS—

COMPREHENSIVE TAX RETURN PROBLEMS

F-1

INDEX

I-1

## Online Appendices

DEPRECIATION AND THE ACCELERATED COST RECOVERY SYSTEM (ACRS)

AFFORDABLE CARE ACT PROVISIONS

## APPENDICES

TAX FORMULAS, TAX RATE SCHEDULES, AND TABLES

A-1

TAX FORMS

B-1

GLOSSARY

C-1





# PART

# 1

# INTRODUCTION AND BASIC TAX MODEL

## CHAPTER 1

### **An Introduction to Taxation and Understanding the Federal Tax Law**

## CHAPTER 2

### **Working with the Tax Law**

## CHAPTER 3

### **Tax Formula and Tax Determination; An Overview of Property Transactions**

Part 1 provides an introduction to taxation in the United States. Although this text focuses on income taxation, other types of taxes also are briefly discussed. The purposes of the Federal tax law are examined, and the legislative, administrative, and judicial sources of Federal tax law, including their application to the tax research process, are analyzed. Part 1 concludes by introducing the basic tax model for the individual taxpayer and providing an overview of property transactions.

# An Introduction to Taxation and Understanding the Federal Tax Law

**LEARNING OBJECTIVES:** After completing Chapter 1, you should be able to:

- |   |  |
|---|--|
| <p><b>LO.1</b> Explain the importance of taxation and apply methods for studying this topic.</p> <p><b>LO.2</b> Describe some of the history and trends of the Federal income tax.</p> <p><b>LO.3</b> Describe and apply principles and terminology relevant to the design of a tax system.</p> <p><b>LO.4</b> Identify the different taxes imposed in the United States at the Federal, state, and local levels.</p> | <p><b>LO.5</b> Explain the administration of the tax law, including the audit process utilized by the IRS.</p> <p><b>LO.6</b> Evaluate some of the ethical guidelines involved in tax practice.</p> <p><b>LO.7</b> Classify tax rules based on their possible economic, social, equity, and political reasons for inclusion in a particular tax system.</p> <p><b>LO.8</b> Explain the role played by the IRS and the courts in the evolution of the Federal tax system.</p> |
|---|--|

## CHAPTER OUTLINE

### 1-1 Approaching the Study of Taxation, 1-2

- 1-1a What Is Taxation? 1-2
- 1-1b Taxation in Our Lives, 1-2
- 1-1c The Relevance of Taxation to Accounting and Finance Professionals, 1-3
- 1-1d How to Study Taxation, 1-4

### 1-2 A Brief History of U.S. Taxation, 1-4

- 1-2a Early Periods, 1-4
- 1-2b Revenue Acts, 1-5
- 1-2c Trends, 1-6

### 1-3 Tax System Design, 1-6

- 1-3a Legal Foundation, 1-6
- 1-3b The Basic Tax Formula, 1-7
- 1-3c Tax Principles, 1-8

### 1-4 Major Types of Taxes, 1-8

- 1-4a Property Taxes, 1-10
- 1-4b Transaction Taxes, 1-11
- 1-4c Taxes on Transfers at Death, 1-13
- 1-4d Gift Taxes, 1-14

1-4e Income Taxes, 1-15

1-4f Employment Taxes, 1-17

1-4g Other U.S. Taxes, 1-18

1-4h Proposed U.S. Taxes, 1-20

### 1-5 Tax Administration, 1-21

- 1-5a Internal Revenue Service, 1-21
- 1-5b The Audit Process, 1-21
- 1-5c Statute of Limitations, 1-23
- 1-5d Interest and Penalties, 1-24
- 1-5e Tax Practice, 1-25

### 1-6 Understanding the Federal Tax Law, 1-26

- 1-6a Revenue Needs, 1-27
- 1-6b Economic Considerations, 1-27
- 1-6c Social Considerations, 1-28
- 1-6d Equity Considerations, 1-29
- 1-6e Political Considerations, 1-31
- 1-6f Influence of the Internal Revenue Service, 1-32
- 1-6g Influence of the Courts, 1-33
- 1-6h Summary, 1-34



## THE BIG PICTURE

### FAMILY AND TAXES—A TYPICAL YEAR

Travis and Amy Carter are married and live in a state that imposes both a sales tax and an income tax. They have two children, April (age 17) and Martin (age 18). Travis is a mining engineer who specializes in land reclamation. After several years with a mining corporation, Travis established a consulting practice that involves a considerable amount of travel due to work he performs in other states. Amy is a registered nurse who, until recently, was a homemaker. In November of this year, she decided to reenter the job market and accepted a position with a medical clinic. The Carters live only a few blocks from Ernest and Mary Walker, Amy Carter's parents. The Walkers are retired and live on interest, dividends, and Social Security benefits.

Activities during the year with possible tax ramifications are summarized below.

- The ad valorem property taxes on the Carters' residence are increased, whereas those on the Walkers' residence are lowered.
- When Travis registers an automobile purchased last year in another state, he is required to pay a sales tax to his home state.
- As an anniversary present, the Carters gave the Walkers a recreational vehicle (RV).
- Travis employs his children to draft blueprints and prepare scale models for use in his work. Both April and Martin have had training in drafting and topography.
- Early in the year, the Carters are audited by the state on an income tax return filed a few years ago. Later in the year, they are audited by the IRS on a Form 1040 they filed for the same year. In each case, a tax deficiency and interest were assessed.
- The Walkers are audited by the IRS. Unlike the Carters, they did not have to deal with an agent, but settled the matter by mail.

Explain these developments, and resolve the issues raised.

***Read the chapter and formulate your response.***