Contents

A Note from the Authors xiv Introduction to Students xxvi	Taxes Should be Convenient 28 Taxes Should be Efficient 28
PART ONE EXPLORING THE TAX ENVIRONMENT Chapter 1	The Classical Standard of Efficiency 29 Taxes as an Instrument of Fiscal Policy 29 Taxes and Behavior Modification 30 Taxes Should be Fair 32 Ability to Pay 32 Horizontal Equity 32 Vertical Equity 33
Taxes and Taxing Jurisdictions 3 Some Basic Terminology 4 The Relationship between Base, Rate, and Revenue 5 Transaction- or Activity-Based Taxes 6 Earmarked Taxes 6 The Pervasive Nature of Taxation 6 Local Taxes 7 State Taxes 8	Distributive Justice 36 The Perception of Inequity 38 Conclusion 38 Key Terms 39 Questions and Problems for Discussion 39 Application Problems 40 Issue Recognition Problems 42 Research Problems 43 Tax Planning Case 43
Federal Taxes 10 Taxes Imposed by Foreign Jurisdictions 12 Jurisdictional Competition 12 Dynamic Nature of Taxation 13 Tax Base Changes 13 Taxes and the Political Process 14 Sources of Federal Tax Law 14	PART TWO FUNDAMENTALS OF TAX PLANNING Chapter 3 Taxes as Transaction Costs 47
Statutory Authority 15 Administrative Authority 15 Judicial Authority 16 Conclusion 16 Key Terms 16 Questions and Problems for Discussion 17 Application Problems 18 Issue Recognition Problems 19 Research Problems 20 Tax Planning Cases 20	The Role of Net Present Value in Decision Making 48 Quantifying Cash Flows 48 The Concept of Present Value 48 The Issue of Risk 50 A Net Present Value Example 51 Taxes and Cash Flows 51 The Significance of Marginal Tax Rate 52 Net Present Value Example Revisited 53 The Uncertainty of Tax Consequences 55
Chapter 2 Policy Standards for a Good Tax 21 Standards for a Good Tax 22 Taxes Should be Sufficient 22 The National Debt 23 How to Increase Tax Revenues 23 Static versus Dynamic Forecasting 23 Behavioral Responses to Rate Changes 25	Structuring Transactions to Reduce Taxes 57 An Important Caveat 58 Transactional Markets 58 Conclusion 62 Key Terms 63 Questions and Problems for Discussion 63 Application Problems 63 Issue Recognition Problems 67 Tax Planning Cases 68

Chapter 4 Maxims of Income Tax Planning 69	PART THREE THE MEASUREMENT OF TAXABLE
Tax Avoidance—Not Evasion 70	INCOME
What Makes Income Tax Planning Possible? 70	Chapter 6
The Entity Variable 71	Taxable Income from Business
Income Shifting 72	Operations 117
Deduction Shifting 72	•
Constraints on Income Shifting 73	Business Profit as Taxable Income 118
The Time Period Variable 73	The Taxable Year 119
Income Deferral and Opportunity Costs 75	Changing a Taxable Year 120
Income Deferral and Rate Changes 76	Annualizing Income on a Short-Period Return 120
The Jurisdiction Variable 77	Methods of Accounting 122
The Character Variable 77	Tax Policy Objectives 123
Determining the Value of Preferential Rates 78	The Cash Method 125
Constraints on Conversion 79	Constructive Receipt 126
Implicit Taxes 79	Prepaid Expenses and Interest 127
Developing Tax Planning Strategies 80	Merchandise Inventories 128
Additional Strategic Considerations 81	Limitations on Use of the Cash Method by
Tax Legal Doctrines 83	Corporations 129
Conclusion 84	The Accrual Method 129
Key Terms 85	Contrasting Perspectives on Income Measurement 130
Questions and Problems for Discussion 85	Permanent versus Temporary Differences 130
Application Problems 86	Tax Expense versus Tax Payable 132
Issue Recognition Problems 89	Temporary Book/Tax Accounting Differences 133
Research Problems 90	Net Operating Losses 139
Tax Planning Cases 90	The Problem of Excess Deductions 139
Turi Training Custs 70	Solution: The NOL Deduction 140
_	Valuing an NOL Deduction 141
Chapter 5	Giving Up an NOL Carryback 142
Tax Research 93	Accounting for NOLs 143 Conclusion 143
Developing Tax Research Skills 93	Sources of Book/Tax Differences 144
The Tax Research Process 94	Key Terms 144
Step 1: Get the Facts 95	Questions and Problems for Discussion 144
Step 2: Identify the Issues 96	Application Problems 145
Step 3: Locate Authority 97	Issue Recognition Problems 152
Primary Authorities 97	Research Problems 154
Secondary Authorities 99	Tax Planning Cases 154
Strategies for Locating Relevant Authority 100	
Step 4: Analyze Authority 103	Chapter 7
Step 5: Repeat Steps 1 through 4 105	Property Acquisitions and Cost Recovery
Step 6: Communicate your Conclusions 106	Deductions 157
Conclusion 108	Deductions 137
Key Terms 109	Deductible Expense or Capitalized Cost? 158
Questions and Problems for Discussion 109	Repairs and Cleanup Costs 159
Application Problems 110	Deductions of Capital Expenditures as Subsidies 160
Issue Recognition Problems 112	The Critical Role of Tax Basis 161
Research Problems 113	Basis, Cost Recovery, and Cash Flow 162
Tax Planning Cases 113	Cost Basis 163

Introduction to Cost Recovery Methods 164 Inventories and Cost of Goods Sold 165	Conclusion 225 Sources of Book/Tax Differences 225
The Unicap Rules 165	Key Terms 225
Computing Cost of Goods Sold 166	Questions and Problems for Discussion 226
Depreciation of Tangible Business Assets 166	Application Problems 227
Book and Tax Concepts of Depreciation 166	Issue Recognition Problems 236
The MACRS Framework 167	Research Problems 237
Limited Depreciation for Passenger Automobiles 173	Tax Planning Cases 237
Section 179 Expensing Election 174	CPA Exam Simulation 239
Bonus Depreciation 176	Chanter 9
Purchase versus Leasing Decision 177	Chapter 9
Amortization of Intangible Assets 178	Nontaxable Exchanges 241
Organizational and Start-Up Costs 178	Tax Neutrality for Asset Exchanges 241
Leasehold Costs and Improvements 180	A Generic Nontaxable Exchange 242
Business Acquisition Intangibles 180	Exchanges of Qualifying Property 242
Comprehensive Example of a Lump-Sum Purchase 182	The Substituted Basis Rule 243
Depletion of Natural Resources 182	The Effect of Boot 244
Percentage Depletion 183 Conclusion 184	Book/Tax Difference from Nontaxable Exchange 245
	Summary 246
Sources of Book/Tax Differences 185	Like-Kind Exchanges 246
Key Terms 185 Ouestions and Problems for Discussion 185	Exchanges of Mortgaged Properties 249
Questions and Problems for Discussion 185 Application Problems 186	Involuntary Conversions 251
Issue Recognition Problems 192	Formations of Business Entities 252
Research Problems 192	Corporate Formations 252
Tax Planning Cases 193	Partnership Formations 254
Appendix 7–A Midquarter Convention Tables 195	Wash Sales 255
Appendix 7-A whoquarter Convention rables 193	Conclusion 255
Charles O	Sources of Book/Tax Differences 256
Chapter 8	Key Terms 256
Property Dispositions 199	Questions and Problems for Discussion 256
Computation of Gain or Loss Recognized 200	Application Problems 257
Sales and Exchanges 201	Issue Recognition Problems 263
Seller-Financed Sales 203	Research Problems 264
Disallowed Losses on Related Party Sales 206	Tax Planning Cases 265
Tax Character of Gains and Losses 208	Comprehensive Problems for Part Three 266
Capital Asset Defined 208	
Capital Loss Limitation 209	PART FOUR
Taxation of Capital Gains 211	THE TAXATION OF BUSINESS INCOME
Capital Asset Definition Revisited 211	THE TAXATION OF BUSINESS INCOME
Dispositions of Noncapital Assets 212	Chapter 10
Inventory 212	•
Business Accounts Receivable and Supplies 213	Sole Proprietorships, Partnerships, LLCs,
Section 1231 Assets 214	and S Corporations 271
Depreciation Recapture 216	Sole Proprietorships 272
Comprehensive Example 220	Overview of Schedule C 272
Other Property Dispositions 222	Employment Taxes 276
Abandonment and Worthlessness 222	Self-Employment Tax 278
Foreclosures 224	Partnerships 279
Casualties and Thefts 224	Forming a Partnership 279

Partnership Reporting Requirements 281 Tax Consequences to Partners 284	Appendix 11–A Schedule M-3 for Reconciling Book and Taxable Income 341
Adjusting the Basis of a Partnership	
Interest 287	Chapter 12
Limited Liability Companies 290	The Choice of Business Entity 345
Subchapter S Corporations 291	•
Eligible Corporations 293	Tax Planning with Passthrough Entities 346
Tax Consequences to Shareholders 295	Tax Benefit of Start-Up Losses 346
Adjusting the Basis of S Corporation	Avoiding a Double Tax on Business Income 347
Stock 297	Income Shifting among Family Members 348
Conclusion 298	Partnership or S Corporation? 351
Key Terms 299	Contrasting Characteristics 351
Questions and Problems for Discussion 299	Two Planning Cases 353
Application Problems 300	Tax Planning with Closely Held Corporations 354
Issue Recognition Problems 304	Getting Cash out of the Corporation 354
Research Problems 306	Decline of the Corporate Tax Shelter 357
Tax Planning Cases 306	Penalty Taxes on Corporate Accumulations 358
CPA Exam Simulation 308	Controlled Corporate Groups 360
	Conclusion 361
Chapter 11	Key Terms 361
The Corporate Taxpayer 309	Questions and Problems for Discussion 361
The Corporate Taxpayer 309	Application Problems 363
Legal Characteristics of Corporations 310	Issue Recognition Problems 366
Affiliated Groups 310	Research Problems 368
Nonprofit Corporations 312	Tax Planning Cases 369
Computing Corporate Taxable Income 312	
The Dividends-Received Deduction 314	Chapter 13
Reconciling Book Income and Taxable Income 315	Jurisdictional Issues in Business
Computing the Regular Corporate Tax 316	Taxation 371
Personal Service Corporations 318	
Reduced Tax Burden on Domestic Manufacturers 318	State and Local Taxation 372
Tax Credits 319	Constitutional Restrictions on State Jurisdiction 372
Rehabilitation Credit 320	Apportionment of Business Income 374
Alternative Minimum Tax 321	Tax Planning Implications 376
Alternative Minimum Taxable Income 322	Gross Receipts Taxes 377
Calculating AMT 324	Tax Consequences of International Business
Minimum Tax Credit 325	Operations 378
Payment and Filing Requirements 326	Income Tax Treaties 378
Distributions of Profits to Investors 327	U.S. Jurisdiction to Tax Global Income 379
Alternatives to Double Taxation 328	Foreign Tax Credit 379
Incidence of the Corporate Tax 329	Limitation on the Annual Credit 380
Conclusion 330	Organizational Forms for Overseas Operations 383
Sources of Book/Tax Differences 330	Branch Offices and Foreign Partnerships 383
Key Terms 330	Domestic Subsidiaries 383
Questions and Problems for Discussion 330	Foreign Subsidiaries 384
Application Problems 331	Deferral of U.S. Tax on Foreign Source Income 386
Issue Recognition Problems 337	Controlled Foreign Corporations 388
Research Problems 338	Transfer Pricing and Section 482 391
Tax Planning Cases 339	Book/Tax Differences Related to Foreign Operations 392
CPA Exam Simulation 340	Conclusion 392

Sources of Book/Tax Differences 393	Tax Consequences of Worker Classification 442
Key Terms 393	Worker Classification Controversy 443
Questions and Problems for Discussion 393	Wage and Salary Payments 445
Application Problems 394	Reasonable Compensation 445
Issue Recognition Problems 399	Foreign Earned Income Exclusion 448
Research Problems 400	Employee Fringe Benefits 449
Tax Planning Cases 401	Fringe Benefits and Self-Employed Individuals 450
Comprehensive Problems for Part Four 402	Compensation Planning with Fringe Benefits 450
Completionsive Problems for Part Pour 402	Employee Stock Options 452
	Book/Tax Difference 454
PART FIVE	
THE INDIVIDUAL TAXPAYER	Incentive Stock Options 454
THE INDIVIDUAL TAXIATER	Employment-Related Expenses 456
Chapter 14	Moving Expenses 456
-	Retirement Planning 457
The Individual Tax Formula 407	Tax Advantages of Qualified Retirement Plans 457
Filing Status for Individuals 408	Premature Withdrawals 459
Married Individuals and Surviving Spouses 408	Types of Qualified Plans 460
Unmarried Individuals 409	Employer-Provided Plans 460
Overview of the Taxable Income Computation 409	Keogh Plans for Self-Employed Individuals 464
-	Individual Retirement Accounts 465
The Four-Step Procedure 409	Contribution Limits 465
Step 1: Calculate Total Income 410	Deduction of IRA Contributions 466
Step 2: Calculate Adjusted Gross Income 410	Withdrawals from IRAs 468
Step 3: Subtract Standard Deduction or Itemized	Rollovers to IRAs 470
Deductions 410	
Step 4: Subtract Exemption Amount 415	Conclusion 472
The Taxable Income Formula 418	Sources of Book/Tax Differences 472
Computing Individual Tax 419	Key Terms 472
The Marriage Penalty Dilemma 421	Questions and Problems for Discussion 472
The Elusive Marginal Tax Rate 422	Application Problems 473
Individual Tax Credits 424	Issue Recognition Problems 479
Child Credit 424	Research Problems 481
Dependent Care Credit 425	Tax Planning Cases 482
Earned Income Credit 425	
Excess Social Security Tax Withholding Credit 426	Chapter 16
Alternative Minimum Tax 427	Investment and Personal Financial
The AMT Trap 429	Planning 485
Payment and Filing Requirements 429	
Conclusion 431	Business Versus Investment Activities 486
Key Terms 432	Investments in Financial Assets 486
Questions and Problems for Discussion 432	Dividend and Interest Income 486
Application Problems 433	Tax-Exempt Interest 488
Issue Recognition Problems 438	Deferred Interest Income 490
Research Problems 439	Life Insurance Policies and Annuity Contracts 492
	Gains and Losses from Security Transactions 494
Tax Planning Cases 440	Computing Gains and Losses 494
Chanter 15	Tax Consequences of Capital Gains and
Chapter 15	Losses 497
Compensation and Retirement Planning 441	Netting Capital Gains and Losses 497
The Compensation Transaction 442	Preferential Rates on Long-Term Capital
Employee or Independent Contractor? 442	Gains 500
Employee of independent Continuous; TT2	2

Policy Reasons for a Preferential Rate 501 Capital Loss Limitation 502 Investments in Small Corporate Businesses 503 Qualified Small Business Stock 503 Section 1244 Stock 504 Investment Expenses 504 Investment Expenses 505 Investments in Real Property 506 Undeveloped Land 506 Rental Real Estate 507 Investments in Passive Activities 508 Passive Activity Loss Limitation 509 Planning with Passive Activity Losses 511	Itemized Deductions as AMT Adjustments 551 Conclusion 553 Key Terms 553 Questions and Problems for Discussion 553 Application Problems 554 Issue Recognition Problems 560 Research Problems 561 Tax Planning Cases 562 Comprehensive Problems for Part Five 563 CPA Exam Simulations 564 Appendix 17–A Social Security Worksheet (Adapted from IRS Publication 915) 566
Unearned Income Medicare Contribution Tax 512 Wealth Transfer Planning 512 The Transfer Tax System 513 The Gift Tax 513	PART SIX THE TAX COMPLIANCE PROCESS
The Estate Tax 515 Conclusion 518 Key Terms 518	Chapter 18 The Tax Compliance Process 569
Questions and Problems for Discussion 518 Application Problems 519 Issue Recognition Problems 525 Research Problems 526 Tax Planning Cases 527 Appendix 16–A Comprehensive Schedule D Problem 529	Filing and Payment Requirements 570 Late-Filing and Late-Payment Penalty 571 Return Processing 572 The Audit Process 573 Your Rights as a Taxpayer 574 Noncompliance Penalties 575 Tax Return Preparer Penalties 578 Contesting the Result of an Audit 578
Chapter 17 Tax Consequences of Personal Activities 535	Contesting the Result of an Audit 578 Litigation 579 A Case History: Lori Williams v. United States 580 Making the Legal System More Taxpayer Friendly 581
Gross Income From Whatever Source Derived 535 Personal Receipts 536 Legal Settlements 537 Government Transfer Payments 538 Gains on Sales of Personal Assets 540 Personal Expenses 541 Medical Expenses 541 Local, State, and Foreign Tax Payments 542	IRS Collection Procedures 582 The Innocent Spouse Rule 583 Conclusion 584 Key Terms 584 Questions and Problems for Discussion 584 Application Problems 586 Issue Recognition Problems 588 Research Problems 589 Tax Planning Cases 589
Charitable Contributions 543 Tax Subsidies for Education 544 Personal Losses 545 Losses on Sales of Personal Assets 545 Casualty and Theft Losses 546	Appendix A Present Value of \$1 593 Appendix B Present Value of Annuity of \$1 594
Hobby and Gambling Losses 547 Tax Consequences of Home Ownership 548 Home Mortgage Interest Deduction 549 Vacation Homes 550 Exclusion of Gain on Sale of Principal Residence 550	Appendix C 2012 Income Tax Rates 595 Glossary 597 Index 609