South Western Federal Taxation 2022 Essentials of Taxation Individuals and Business Entities 25th edition Nellen Test Bank

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Name:_____ Class:_____ Date:_____

Ch 1 Introduction To Taxation

True / False

1. The Medicare component of the FICA tax (1.45% on wages) is *progressive* since the tax due increases as wages increase.
   a. True
   b. False

ANSWER: False

2. The Federal estate and gift taxes are examples of *progressive* rate taxes.
   a. True
   b. False

ANSWER: True

3. The Federal excise tax on gasoline has a *proportional* effect on all taxpayers (that is, neither progressive or regressive).
   a. True
   b. False

ANSWER: False

4. Currently, the Federal corporate income tax is less *progressive* than the individual income tax.
   a. True
   b. False

ANSWER: True

5. Mona inherits her mother's personal residence, which she converts to a furnished rental house. These changes should affect the amount of *ad valorem* property taxes levied on the properties.
   a. True
   b. False

ANSWER: True

6. A *fixture* will be subject to the *ad valorem* tax on *personalty* rather than the *ad valorem* tax on *realty*.
   a. True
   b. False

ANSWER: False

7. Even if property tax rates are not changed, the amount of *ad valorem* taxes imposed on realty may not remain the same.
   a. True
   b. False

ANSWER: True

8. The *ad valorem* tax on personal use personalty is more often avoided by taxpayers than the *ad valorem* tax on business use personalty.
   a. True
   b. False

ANSWER: True

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Ch 1 Introduction To Taxation

9. An excise tax is often used to try to influence behavior.
   a. True
   b. False

ANSWER: True

10. There is a Federal excise tax on hotel occupancy.
   a. True
   b. False

ANSWER: False

11. The Federal gas-guzzler tax applies only to automobiles manufactured overseas and imported into the United States.
   a. True
   b. False

ANSWER: False

12. The amount of the state excise taxes on gasoline varies from state to state.
   a. True
   b. False

ANSWER: True

13. Not all of the states that impose a general sales tax also have a use tax.
   a. True
   b. False

ANSWER: False

14. Sales made over the internet are not exempt from the application of a general sales (or use) tax.
   a. True
   b. False

ANSWER: True

15. Two persons who live in the same state but in different counties may not be subject to the same general sales tax rate.
   a. True
   b. False

ANSWER: True

16. States impose either a state income tax *or* a general sales tax, but not both types of taxes.
   a. True
   b. False

ANSWER: False

17. A safe and easy way for a taxpayer to avoid local and state sales taxes is to make the purchase in a state that levies no such taxes.
   a. True
   b. False

ANSWER: False

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18. On transfers by death, the Federal government relies on an estate tax, while states may impose an estate tax, an inheritance tax, both taxes, or neither tax.

a. True

b. False

ANSWER: True

19. An inheritance tax is a tax on a decedent's right to pass property at death.

a. True

b. False

ANSWER: False

20. One of the major reasons for the enactment of the Federal estate tax was to prevent large amounts of wealth from being accumulated within a family unit.

a. True

b. False

ANSWER: True

21. Under Clint's will, all of his property passes to either the Lutheran Church or to his wife. No Federal estate tax will be due on Clint's death.

a. True

b. False

ANSWER: True

22. Under the usual state inheritance tax, two heirs, a cousin and a son of the deceased, would not be taxed at the same rate.

a. True

b. False

ANSWER: True

23. The annual exclusion, currently $15,000, is available for gift and estate tax purposes.

a. True

b. False

ANSWER: False

24. In 2021, José, a widower, sells land (fair market value of $100,000) to his daughter, Linda, for $50,000. José has not made a taxable gift.

a. True

b. False

ANSWER: False

25. Julius, a married taxpayer, makes gifts to each of his six children. A maximum of twelve annual exclusions could be allowed as to these gifts.

a. True

b. False

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ANSWER: True

26. One of the motivations for making a gift is to save on income taxes.
    a. True
    b. False
ANSWER: True

27. The formula for the Federal income tax on corporations is the same as that applicable to individuals.
    a. True
    b. False
ANSWER: False

28. A state income tax *can* be imposed on *nonresident* taxpayers who earn income within the state on an itinerant basis.
    a. True
    b. False
ANSWER: True

29. For state income tax purposes, some states allow a credit for dependents rather than a deduction.
    a. True
    b. False
ANSWER: True

30. Some states use their state income tax return as a means of collecting unpaid sales and use taxes.
    a. True
    b. False
ANSWER: True

31. No state may offer an income tax amnesty program more than once.
    a. True
    b. False
ANSWER: False

32. For Federal income tax purposes, there never has been a general amnesty period.
    a. True
    b. False
ANSWER: True

33. Under state amnesty programs, all delinquent and unpaid income taxes are forgiven.
    a. True
    b. False
ANSWER: False

34. When a state decouples from a Federal tax provision, it means that this provision will *not* apply for state income tax purposes.
    a. True

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b. False

ANSWER: True

35. The principal objective of the FUTA tax is to provide some measure of retirement security.
a. True
b. False

ANSWER: False

36. Currently, the tax base for the Social Security component of the FICA is *not* limited to a dollar amount.
a. True
b. False

ANSWER: False

37. A parent employs his twin daughters, age 17, in his sole proprietorship. The daughters are *not* subject to FICA coverage.
a. True
b. False

ANSWER: True

38. Unlike FICA, FUTA requires that employers comply with state as well as Federal rules.
a. True
b. False

ANSWER: True

39. A major advantage of a flat tax type of income tax is its simplicity.
a. True
b. False

ANSWER: True

40. The objective of *pay-as-you-go* (*paygo*) is to improve administrative feasibility.
a. True
b. False

ANSWER: True

41. When Congress enacts a tax cut that is phased in over a period of years, revenue neutrality is achieved.
a. True
b. False

ANSWER: False

42. A tax cut enacted by Congress that contains a *sunset provision* will make the tax cut temporary.
a. True
b. False

ANSWER: True

43. The tax law provides various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain

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additional education. These provisions can be justified on both economic and equity grounds.

a. True

b. False

ANSWER: False

44. Various tax provisions encourage the creation of certain types of retirement plans. Such provisions can be justified on both economic and social grounds.

a. True

b. False

ANSWER: True

45. To lessen or eliminate the effect of multiple taxation, a taxpayer who is subject to both foreign and U.S. income taxes on the same income is allowed either a deduction or a credit for the foreign tax paid.

a. True

b. False

ANSWER: True

46. To mitigate the effect of the annual accounting period concept, the tax law permits the carryforward of excess charitable contributions of a particular year to other years.

a. True

b. False

ANSWER: True

47. Jason's business warehouse is destroyed by fire. Because the insurance proceeds exceed the basis of the property, a gain results. If Jason shortly reinvests the proceeds in a new warehouse, no gain is recognized due to the application of the wherewithal to pay concept.

a. True

b. False

ANSWER: True

48. Because it is consistent with the wherewithal to pay concept, the tax law requires a seller to recognize a gain in the year the installment sale occurs.

a. True

b. False

ANSWER: False

49. Stealth taxes have the effect of generating additional taxes from all taxpayers.

a. True

b. False

ANSWER: False

50. A provision in the law that compels accrual basis taxpayers to pay a tax on prepaid income in the year received and *not* when earned is consistent with generally accepted accounting principles.

a. True

b. False

ANSWER: False

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51. As a matter of administrative convenience, the IRS would prefer to have Congress decrease (rather than increase) the amount of the standard deduction allowed to individual taxpayers.

a. True

b. False

ANSWER: False

52. In cases of doubt, courts have held that tax relief provisions should be broadly construed in favor of taxpayers.

a. True

b. False

ANSWER: False

53. On occasion, Congress has to enact legislation that clarifies the tax law in order to change a result reached by the U.S. Supreme Court.

a. True

b. False

ANSWER: True

54. Ultimately, most taxes are paid by individuals.

a. True

b. False

ANSWER: True

55. Tomas owns a sole proprietorship, and Lucy is the sole shareholder of a C corporation. In the current year, both businesses make a net profit of $60,000. Neither business distributes any funds to the owners in the year. For the current year, Tomas must report $60,000 of income on his individual tax return, but Lucy is not required to report any income from the corporation on her individual tax return.

a. True

b. False

ANSWER: True

56. Carol and Candace are equal partners in Peach Partnership. In the current year, Peach had a net profit of $75,000 ($250,000 gross income – $175,000 operating expenses) and distributed $25,000 to each partner. Peach must pay tax on $75,000 of income.

a. True

b. False

ANSWER: False

57. Rajib is the sole shareholder of Cardinal Corporation, a calendar year S corporation. In the current year, Cardinal generated a net profit of $350,000 ($520,000 gross income – $170,000 operating expenses) and distributed $80,000 to Rajib. Rajib must report the Cardinal Corporation profit of $350,000 on his Federal income tax return.

a. True

b. False

ANSWER: True

58. Donald owns a 45% interest in a partnership that earned $130,000 in the current year. He also owns 45% of the stock

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in a C corporation that earned $130,000 during the year. Donald received $20,000 in distributions from each of the two entities during the year. With respect to this information, Donald must report $78,500 of income on his individual income tax return for the year.

a. True

b. False

ANSWER: True

59. Quail Corporation is a C corporation that generates net income of $125,000 during the current year. If Quail paid dividends of $25,000 to its shareholders, the corporation must pay tax on $100,000 of net income. Shareholders must report the $25,000 of dividends as income.

a. True

b. False

ANSWER: False

Multiple Choice

60. Which, if any, of the following statements best describes the history of the Federal income tax?

a. It did not exist during the Civil War.

b. The Federal income tax on corporations was held by the U.S. Supreme Court to be allowable under the U.S. Constitution.

c. The Federal income tax on individuals was held by the U.S. Supreme Court to be allowable under the U.S. Constitution.

d. Both the Federal income tax on individuals and on corporations was held by the U.S. Supreme Court to be contrary to the U.S. Constitution.

ANSWER: b

61. Which, if any, of the following taxes are *regressive* (rather than *progressive*)?

a. State general sales tax

b. Federal individual income tax

c. Federal estate tax

d. Federal gift tax

ANSWER: a

62. Which, if any, of the following transactions will *increase* a taxing jurisdiction's revenue from the *ad valorem* tax imposed on real estate?

a. A resident dies and leaves his farm to his church.

b. A large property owner issues a conservation easement as to some of her land.

c. A tax holiday issued 10 years ago has expired.

d. A bankrupt motel is acquired by the Red Cross and is to be used to provide housing for homeless persons.

e. None of these.

ANSWER: c

63. Which, if any, of the following transactions will *decrease* a taxing jurisdiction's *ad valorem* tax revenue imposed on real estate?

a. A tax holiday is granted to an out-of-state business that is searching for a new factory site.

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b. An abandoned church is converted to a restaurant.
c. A public school is razed and turned into a city park.
d. A local university sells a dormitory that will be converted for use as an apartment building.

ANSWER: a

64. Which, if any, of the following is a typical characteristic of an *ad valorem* tax on personalty?
a. Taxpayer compliance is greater for personal use property than for business use property.
b. The tax on automobiles sometimes considers the age of the vehicle.
c. Most states impose a tax on intangibles.
d. The tax on intangibles generates considerable revenue since it is difficult for taxpayers to avoid.

ANSWER: b

65. Federal excise taxes that are *no longer imposed* include:
a. Tax on air travel.
b. Tax on wagering.
c. Tax on alcohol.
d. None of these.

ANSWER: d

66. Taxes *not imposed* by the Federal government include:
a. Tobacco excise tax.
b. Customs duties (tariffs on imports).
c. Tax on rental cars.
d. Gas guzzler tax.

ANSWER: c

67. Taxes levied by *both* states and the Federal government include:
a. General sales tax.
b. Customs duties.
c. Hotel occupancy tax.
d. None of these.

ANSWER: d

68. Taxes levied by *all* states include:
a. Tobacco excise tax.
b. Individual income tax.
c. Inheritance tax.
d. General sales tax.

ANSWER: a

69. A use tax is imposed by:
a. The Federal government and all states.
b. The Federal government and a majority of the states.
c. All states but not the Federal government.

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d. Most of the states but not the Federal government.

ANSWER: d

70. Gabriele and Lisa are married and live in a common law state. They want to make gifts to their four children in 2021. What is the maximum amount of the annual exclusion they will be allowed for these gifts?

a. $15,000.

b. $30,000.

c. $60,000.

d. $120,000.

ANSWER: d

71. Property can be transferred within the family group by gift or at death. One motivation for preferring the gift approach is:

a. To take advantage of the higher unified transfer tax credit available under the gift tax.

b. To avoid a future decline in value of the property transferred.

c. To take advantage of the per donee annual exclusion.

d. To shift income to higher bracket donees.

ANSWER: c

72. Indicate which, if any, statement is *incorrect*. State income taxes:

a. Can piggyback to the Federal version.

b. Cannot apply to visiting nonresidents.

c. Can decouple from the Federal version.

d. Can provide occasional amnesty programs.

ANSWER: b

73. State income taxes *generally* can be characterized by:

a. The same date for filing as the Federal income tax.

b. No provision for withholding procedures.

c. Allowance of a deduction for Federal income taxes paid.

d. Applying only to individuals but not to corporations.

ANSWER: a

74. A characteristic of FICA tax is that:

a. It does not apply when one spouse works for the other spouse.

b. It is imposed only on the employer.

c. It provides a modest source of income in the event of loss of employment.

d. None of these.

ANSWER: d

75. A characteristic of FUTA is that:

a. It is imposed on both employer and employee.

b. It is imposed solely on the employee.

c. Compliance requires following guidelines issued by both state and Federal regulatory authorities.

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d. It is applicable to spouses of employees but *not* to any children under age 18.

ANSWER: c

76. The United States (either Federal, state, or local) *does not* impose:
a. Franchise taxes.
b. Severance taxes.
c. Custom duties.
d. Export duties.

ANSWER: d

77. Both economic and social considerations can be used to justify:
a. Favorable tax treatment for accident and health plans provided for employees and financed by employers.
b. Disallowance of any deduction for expenditures deemed to be contrary to public policy (e.g., fines, penalties, illegal kickbacks, bribes to government officials).
c. Various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain additional education.
d. Allowance of a deduction for state and local income taxes paid.

ANSWER: c

78. Social considerations can be used to justify:
a. Allowance of a credit for child care expenses.
b. Allowing excess capital losses to be carried over to other years.
c. Allowing accelerated amortization for the cost of installing pollution control facilities.
d. Allowing a Federal income tax deduction for state and local sales taxes.

ANSWER: a

79. Allowing a tax credit for certain solar energy property can be justified:
a. As helping small businesses.
b. As promoting administrative feasibility.
c. As promoting a government policy to use alternative energy sources.
d. Based on the wherewithal to pay concept.

ANSWER: c

80. Provisions in the tax law that promote energy conservation and more use of alternative (nonfossil) fuels can be justified by:
a. Political considerations.
b. Economic and social considerations.
c. Promoting administrative feasibility.
d. Encouragement of small business.

ANSWER: b

81. Which, if any, of the following provisions *cannot* be justified as mitigating the effect of the annual accounting period concept?
a. Nonrecognition of gain allowed for involuntary conversions.

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b. Net operating loss carryover provisions.

c. Use of the installment method to recognize gain.

d. Carryover of excess capital losses.

ANSWER: a

82. Which, if any, of the following provisions of the tax law *cannot* be justified as promoting administrative feasibility (simplifying the task of the IRS)?

a. Penalties are imposed for failure to file a return or pay a tax on time.

b. Annual adjustments for indexation increases the amount of the standard deduction allowed.

c. Personal casualty losses in Federally declared disaster areas must exceed 10% of AGI to be deductible.

d. A deduction is allowed for charitable contributions.

ANSWER: d

83. A landlord leases property upon which the tenant makes improvements. The improvements are significant and are not made in lieu of rent. At the end of the lease, the value of the improvements are not income to the landlord. This rule is an example of:

a. A clear reflection of income result.

b. The tax benefit rule.

c. The arm's length concept.

d. The wherewithal to pay concept.

ANSWER: d

84. Two years ago, State Y enacted a new income tax credit for college prep materials. The credit is available to individuals and is equal to 40% of the cost of the items. The credit may not exceed $50 in any year. State Y's director of finance has discovered this year that the amount of credit claimed is far higher than expected. Which principle of good tax policy might not have been considered in designing this tax that caused the original cost estimate to be too low?

a. Equity.

b. Simplicity.

c. Economy in collection.

d. Minimum tax gap.

ANSWER: d

85. Which of the following taxes is paid *only* by the employer?

a. FICA

b. FUTA

c. Social Security tax

d. Medicare tax

ANSWER: b

86. A rationale for the installment sale method tax rule is:

a. Ability to pay.

b. Equity and fairness.

c. Simplicity.

d. Revenue neutrality.

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ANSWER: a

Matching

Using the following choices, show the justification for each provision of the tax law listed.
a. Economic considerations
b. Social considerations
c. Equity considerations
d. Both a. and b.

87. A tax credit for amounts spent to furnish care for children while the parent is at work.
ANSWER: b

88. Additional depreciation deduction allowed for the year the asset is acquired.
ANSWER: a

89. Tax brackets are increased for inflation.
ANSWER: c

90. A small business corporation can elect to avoid the corporate income tax.
ANSWER: a

91. A deduction for contributions by an employee to certain retirement plans.
ANSWER: d

92. A deduction for qualified tuition paid to obtain higher education.
ANSWER: d

93. A deduction for certain expenses (interest and taxes) incident to home ownership.
ANSWER: d

94. A Federal deduction for state and local income taxes paid.
ANSWER: c

95. A deduction for interest on student loans.
ANSWER: d

96. A bribe to the local sheriff, although business related, is not deductible.
ANSWER: b

97. Contributions to charitable organizations are deductible.
ANSWER: b

98. A Federal deduction for state and local sales taxes paid.
ANSWER: c

99. Tax credits available for the purchase of a vehicle that uses alternative (nonfossil) fuels.

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ANSWER: a

100. Tax credits for home improvements that conserve energy.
ANSWER: a

101. More rapid expensing for tax purposes of the costs of installing pollution control devices.
ANSWER: a

Subjective Short Answer

102. Taylor, a widow, makes cash gifts to her five married children (including their spouses) and to her seven grandchildren. What is the maximum amount Taylor can give for calendar year 2021 without using her unified transfer tax credit?
ANSWER: $255,000 [$15,000 (annual exclusion) × 17 donees].

103. Paige is the sole shareholder of Citron Corporation. During the year, she leases a building to Citron for a monthly rental of $80,000. If the fair rental value of the building is $60,000, what are the income tax consequences to the parties involved?
ANSWER: The rent charged by Paige is not "arms length"; as such, Citron Corporation's rent deduction is $60,000 (not $80,000). The $20,000 difference is a nondeductible dividend distribution. For Paige, the change merely requires reclassification. Instead of $80,000 of rent income, she has $60,000 of rent income and $20,000 of dividend income.

Essay

104. The Federal income tax is based on a pay-as-you-go system and has become a "mass tax." Explain this statement.
ANSWER: The pay-as-you-go system is present in the wage and other withholding procedures. In the case of self-employed persons, it is manifested in the required quarterly payments for estimated taxes. The income tax became a mass tax during World War II when its coverage was extended to 74% of the population (from less than 6% in 1939).

105. Due to population change, Goose Creek School District has decided to close one of its high schools. Since it has no further need of the property, the school is listed for sale. The two bids it receives are as follows:

United Methodist Church	$1,700,000
Planet Motors	1,600,000

The United Methodist Church would use the property to establish a sectarian middle school. Planet, a well-known car dealership, would revamp the property and operate it as a branch location.

If you were a member of the School District board, what factors would you consider in evaluating the two bids?
ANSWER: Although the bid from the United Methodist Church is higher, several other factors need to be considered. Does, for example, Goose Creek School District exempt property owned by churches from its *ad valorem* taxes? If so, losing this property from the tax base could prove very costly over the long run. Also, it is probable that income-producing property (such as a car dealership) would be taxed at a higher rate than that owned by a nonprofit organization (a school operated by a church). This assumes, of course, that the school would be taxed at all. The auto dealership also would generate sales tax.

106. Morgan inherits her father's personal residence including all of the furnishings. She plans to add a swimming pool and sauna to the property and rent it as a furnished house. What are some of the *ad valorem* property tax issues Morgan

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can anticipate?

ANSWER: The real estate taxes probably will increase for several reasons. The capital improvements and the conversion from residential to rental will trigger the increase. Furthermore, the furnishings may generate an *ad valorem* tax on personalty. (Depending on applicable law, furniture might not be subject to tax unless used for business purposes—such as in this case.)

107. In 2019, Deborah became 65 years old. In 2020 she added a swimming pool and in 2021 she converted the residence to rental property and moved into an assisted living facility. Since 2018, Deborah's *ad valorem* property taxes have decreased once and increased twice. Explain.

ANSWER: The decrease probably came in 2019 when Deborah reached age 65. The increases probably occurred in 2020 when she added the pool and in 2021 when the residence was converted to rental property with the property reassessed due to the change in use and/or removal of the homestead exemption.

108. A lack of compliance in the payment of use taxes can be resolved by several means. In this regard, comment on the following:

a. Registration of automobiles.
b. Reporting of Internet purchases on state income tax returns.

ANSWER:
a. As reflected in Example 5, re-registration of a car purchased out of state is the occasion for the owner's home state to collect the use tax.
b. Completing the state income tax return reminds (or forces) the taxpayer to pay use tax on out of state purchases.

109. What are the pros and cons of the following state and local tax provisions?

a. An *ad valorem* property tax holiday made available to a manufacturing plant that is relocating.
b. Hotel occupancy tax and a rental car surcharge.
c. A back-to-school sales tax holiday.

ANSWER:
a. Such a holiday is designed to attract new industry to the area. This will bring more jobs and growth in consumption. On the other hand, if the tax holiday is too generous, this places a strain on available public revenue. The result could be that schools and capital maintenance (roads, public services) will suffer.
b. The hotel occupancy tax and car rental surcharges are popular because they mainly impact visitors. Also, they can generate considerable revenue to finance major capital improvements. If these taxes become excessive, however, they could discourage major events (such as conventions).
c. Such holidays are very popular with both merchants and consumers and serve the social need of defraying some of the costs of sending children to school. Once established, however, they are difficult to get rid of. Thus, they become an annual drain on sales tax revenue.

110. What is a severance tax? How productive can it be in terms of generating revenue?

ANSWER: A severance tax is one imposed when natural resources (e.g., oil, gas, iron ore, coal) are extracted. It is based on the notion that the state has an interest in such resources. For some states, the revenue from severance taxes can be significant. Alaska, for example, relies heavily on its severance taxes and has been able to avoid both a state income tax and a general sales tax.

111. What is the difference between an inheritance tax and an estate tax? Who imposes these taxes?

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ANSWER: An inheritance tax is a tax on the right to receive property from a decedent. An estate tax is imposed on the right to pass property at death. The Federal government imposes estate taxes and states impose inheritance taxes. Some states impose both, whereas others impose neither.

112. Antonio dies with an estate worth $20 million. Under his will, $10 million passes to his wife and $10 million goes to his church. What is Antonio's Federal estate tax result?

ANSWER: None. After a marital deduction of $10 million and a charitable deduction of $10 million, Antonio's taxable estate is $0.

113. What might cause an individual to owe income taxes in more than one state?

ANSWER: Working in more than one state or owning income-generating property in more than one state can cause this.

114. Virtually all state income tax returns contain checkoff boxes for donations to various causes. On what grounds has this procedure been criticized?

ANSWER: In many cases, the procedure is overused (i.e., a multiplicity of boxes). This overuse adds complexity to the return. Also, in most cases, the donation is being drawn from any income tax refund that might be due. Thus, taxpayers may not fully appreciate that they are paying for such checkoffs.

115. State and local governments are sometimes forced to find ways to generate additional revenue. Comment on the pros and cons of the following procedures:

a. Decouple what would be part of the piggyback format of the state income tax.
b. Tax amnesty provisions.
c. Internet shaming.

ANSWER:
a. The decoupling process is easily accomplished regarding new Federal tax changes that have never taken effect at the state level. Taxpayers are not apt to miss what they never have enjoyed.
b. Tax amnesty provisions generate considerable revenue. It also unmasks many taxpayers who have not previously paid taxes. Now that the taxing jurisdiction is aware of their existence, they will tend to pay taxes in the future.
c. By use of a public internet site, the taxing authority posts the names of those taxpayers that are delinquent as to various taxes (e.g., sales, income). This public humiliation (or threat of) very often results in compliance.

116. Briana lives in one state and works in the adjoining state. Both states tax the income she earns from her job. Does Briana have any relief from this apparent double taxation of the same income?

ANSWER: Most states allow their residents some form of tax credit for the income taxes paid to other states. In Briana's case, the credit would be allowed by the state where she lives for the taxes paid to the state where she works.

117. In terms of revenue neutrality, comment on a tax cut enacted by Congress that:

a. Contains revenue offsets.
b. Includes a sunset provision.

ANSWER:
a. Ideally, to achieve revenue neutrality, all tax cuts should be accompanied by revenue offsets.
b. A sunset provision does not account for the immediate revenue losses generated by a tax cut. It merely provides that such losses will not continue beyond a specified date when the tax cut expires and the former tax law is reinstated.

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118. The tax law contains various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain additional education. On what grounds can these provisions be justified?

ANSWER: Social and economic considerations are the justification. As to the latter, a better educated workforce carries a positive economic impact.

119. The tax law contains various provisions that encourage home ownership.

a. On what basis can this objective be justified?
b. Are there any negative considerations? Explain.

ANSWER: a. Home ownership can be justified on economic and social grounds.
b. Granting tax advantages to persons who are purchasing their homes places the taxpayers who rent at a disadvantage. The result is inequality in treatment.

120. The tax law allows an income tax deduction (or a credit) for foreign income taxes. Explain why.

ANSWER: The deduction (or a credit) for foreign income taxes can be justified on the grounds that it mitigates the double tax imposed on the same income.

121. The tax law allows, under certain conditions, deferral of gain recognition for involuntary conversions.

a. What is the justification for this relief measure?
b. What happens if the proceeds are not entirely reinvested?

ANSWER: a. By recognizing that the taxpayer's relative economic situation has not changed and that they lack the wherewithal to pay a tax, any recognition of realized gain is deferred.
b. If the proceeds from an involuntary conversion are not fully reinvested in property that is similar or related in service or use, recognized gain results. Such recognized gain cannot exceed realized gain and will be limited to the amount of the proceeds not reinvested. Recognition is based on the notion that the taxpayer now has the wherewithal to pay the tax that results.

122. How do the net operating loss provisions in the tax law mitigate the effect of the annual accounting concept?

ANSWER: Without the allowance of a loss carryforward, the losses would disappear. As shown by Example 26, this result places a business with profit and loss fluctuations on a more level playing field with one that maintains a stable income pattern.

123. In connection with facilitating the function of the IRS in the administration of the tax laws, comment on the utility of the following:

a. An increase in the amount of the standard deduction.
b. Dollar and percentage limitations on the deduction of personal casualty losses in Federally declared disaster areas.
c. Availability of interest and penalties for taxpayer noncompliance.

ANSWER: a. An increase in the amount of the standard deduction reduces the number of taxpayers who choose to itemize their personal deductions. This, in turn, reduces the deductions the IRS has to check.
b. Limitations placed on casualty and theft losses curtail the number of taxpayers who can claim the deduction.
c. The imposition of extra penalties, in addition to the tax owed, definitely deters

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taxpayer noncompliance.

124. Congress reacts to judicial decisions that interpret the tax law in different ways. When it approves of a decision, Congress may act to amend the Code to incorporate the holding. When it disapproves, Congress may amend the Code to nullify its effect. Give an example of each one of these congressional reactions.

ANSWER: Congress approved of the judicial conclusion that most stock dividends should be nontaxable and amended the Code to this effect. However, it disagreed as to when leasehold improvements should be taxed to a lessor. Consistent with the wherewithal to pay concept, the improvements are to be taxed on the termination of the lease. Thus, Congress overturned a judicial holding that would have taxed such improvements in the year they are made by the lessee.

125. Ultimately, most taxes are paid by individuals. Explain what this means in terms of income and payroll taxes paid by a corporation.

ANSWER: A corporation pays many types of taxes, but like any other expenditure, some of these taxes are ultimately paid by an individual. Income taxes are included in the price the corporation charges for goods and services. Or all or part might result in reduced earnings affecting investors or through reduced wages affecting employees. The payroll taxes paid by the corporate employer are likely borne by workers in the form of lower wages. That is, if the employer did not have to pay the taxes, it could pay higher wages to employees. These taxes might also be borne by customers and investors.

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