

SOUTH-WESTERN  
FEDERAL TAXATION

Raabe  
Maloney  
Young  
Smith  
Nellen

# ESSENTIALS OF TAXATION

Individuals and Business Entities

2016

Included:

H&R  
BLOCK TAX  
SOFTWARE

THOMSON REUTERS  
**CHECKPOINT**  
Student Edition





**SOUTH-WESTERN**  
**FEDERAL TAXATION**

**2016 EDITION**  
**ESSENTIALS OF**  
**TAXATION: INDIVIDUALS**  
**AND BUSINESS ENTITIES**

**General Editors**

**William A. Raabe**

Ph.D., CPA  
University of Wisconsin-  
Whitewater

**David M. Maloney**

Ph.D., CPA  
University of Virginia

**James C. Young**

Ph.D., CPA  
Northern Illinois University

**James E. Smith**

Ph.D., CPA  
College of William and Mary

**Annette Nellen**

J.D., CPA, CGMA  
San Jose State University



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

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:  
Essentials of Taxation: Individuals and  
Business Entities, 2016 Edition**

**William A. Raabe, David M. Maloney, James  
C. Young, James E. Smith, Annette Nellen**

Vice President, General Manager, Science,  
Math, and Quantitative Business: Balraj Kalsi

Product Director: Mike Schenk

Sr. Product Manager: Sharon Oblinger

Associate Marketing Manager: Charisse Darin

Sr. Content Developer: Kendra Brown

Content Developer: Lysa Kosins

Sr. Content Project Manager: Tim Bailey

Content Digitization Project Manager: Thomas  
Burns

Manufacturing Planner: Doug Wilke

Production Service: Cenveo Publisher Services

Sr. Art Director: Michelle Kunkler

Cover and Internal Designer: Red Hangar  
Design

Intellectual Property:

Analyst: Christina Ciaramella

Project Manager: Betsy Hathaway

Cover Image: Getty Images/John Lund

Design Images:

Concept Summary, Global Tax Issues, Tax in  
the News, Bridge Discipline: enot-poloskun/  
iStockphoto.com

Ethics & Equity: LdF/iStockphoto

Comprehensive Tax Return Problems: peepo/  
iStockphoto

Internet Activity: alexsl/iStockphoto

Financial Disclosure Insights: Vyaseleva  
Elena/Shutterstock

Tax Plan Strategies: Sergey Nivens/  
Shutterstock

Tax Fact: carroteater/Shutterstock

Framework 1040: Concept Photo/  
Shutterstock

Digging Deeper: tuulijumala/Shutterstock

© 2016, 2015 Cengage Learning

WCN: 02-200-203

ALL RIGHTS RESERVED. No part of this work covered by the copyright herein may be reproduced, transmitted, stored, or used in any form or by any means graphic, electronic, or mechanical, including but not limited to photocopying, recording, scanning, digitizing, taping, Web distribution, information networks, or information storage and retrieval systems, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without the prior written permission of the publisher.

For product information and technology assistance, contact us at  
**Cengage Learning Customer & Sales Support, 1-800-354-9706**

For permission to use material from this text or product,  
submit all requests online at **www.cengage.com/permissions**  
Further permissions questions can be emailed to  
**permissionrequest@cengage.com**

Unless otherwise noted, all items © Cengage Learning.

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

Student Edition ISBN: 978-1-305-39531-2

Student Edition with CD ISBN: 978-1-305-39530-5

ISSN: 1544-3590

2016 Annual Edition

**Cengage Learning**

20 Channel Center Street

Boston, MA 02210

USA

Cengage Learning 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**.

Cengage Learning products are represented in Canada by Nelson Education, Ltd.

To learn more about Cengage Learning Solutions, visit **www.cengage.com**

Purchase any of our products at your local college store or at our preferred online store **www.cengagebrain.com**

Printed in the United States of America

Print Number: 01      Print Year: 2015

## Authors for the South-Western Federal Taxation Series

**Greg Carnes**

Ph.D, CPA  
University of  
North Alabama

**Andrew Cuccia**

Ph.D, CPA  
The University of  
Oklahoma

**Kristina Zvinakis**

Ph.D.  
The University of  
Texas at Austin



# 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.

*Essentials of Taxation: Individuals and Business Entities*, 2016 Edition provides a dynamic learning experience inside and outside of the classroom. Built with resources and tools that have been identified as the most important, our complete learning system provides options for students to achieve success.

*Essentials of Taxation: Individuals and Business Entities*, 2016 Edition provides accessible, comprehensive, and authoritative coverage of the relevant tax code and regulations as they pertain to the individual or business taxpayer, as well as coverage of all major developments in Federal Taxation.

### In revising the 2016 Edition, we focused on:

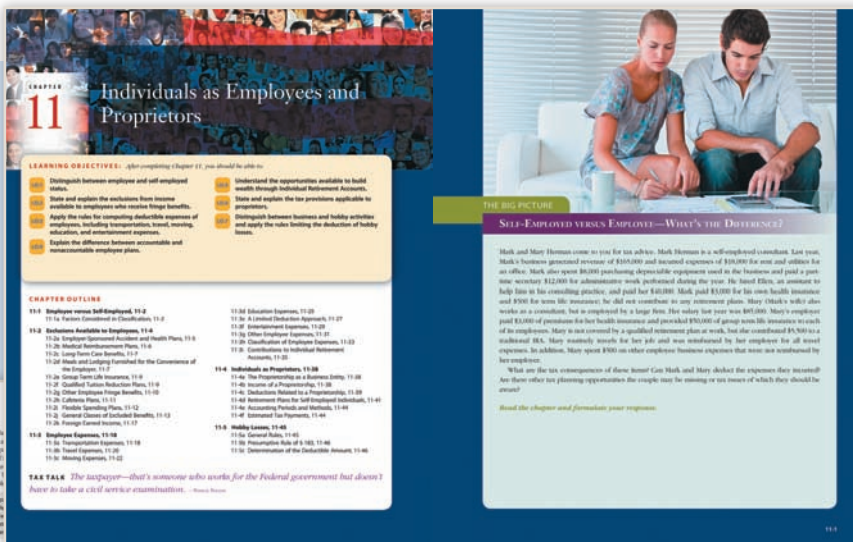
- **Accessibility. Clarity. Substance.** The text authors and editors made this their mantra as they revised the 2016 edition. Coverage has been streamlined to make it more accessible to students, and difficult concepts have been clarified, all without losing the substance that makes up the *South-Western Federal Taxation* series.
- **CengageNOW 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 CengageNOW to meet evolving student and instructor needs. CengageNOW 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

**NEW! FULL-COLOR DESIGN:** We understand that students struggle with learning difficult tax code concepts and applying them to real-world scenarios. The 2016 edition has been developed with an invigorating use of color that brings the text to life, captures student attention, and presents the tax code in a simple, yet logical format.

- Selected content has been streamlined to guide students in focusing on the most important concepts for the CPA exam while still providing in-depth coverage of topics.



**CHAPTER 11 Individuals as Employees and Proprietors**

**LEARNING OBJECTIVES:** After completing Chapter 11, you should be able to:

- Distinguish between employee and self-employed status.
- State and explain the exclusions from income tax for employees who receive fringe benefits.
- Apply the rules for computing deductible expenses of employees, including transportation, travel, meals, education, and entertainment expenses.
- Explain the difference between accountable and nonaccountable employee plans.
- Understand the opportunities available to build wealth through individual retirement accounts.
- State and explain the tax provisions applicable to proprietors.
- Distinguish between business and hobby activities and apply the rules limiting the deduction of hobby losses.

**CHAPTER OUTLINE**

**11.0 Employee versus Self-Employed, 11-2**

11.1 Factors Considered in Classification, 11.2

**11.10 Income Available for Taxation, 11-8**

11.20 Employment-Related Expenses and Health Plans, 11-8

11.21 Charitable Deductions, 11-8

11.22 Long-Term Care Benefits, 11-9

11.23 Social and Capital Gains in the Context of the Employee, 11-9

11.24 Group-Term Life Insurance, 11-9

11.25 Qualified Tuition Reduction Plans, 11-9

11.26 Other Employee Fringe Benefits, 11-9

11.27 Cafeteria Plans, 11-11

11.28 Flexible Spending Plans, 11-12

11.29 General Classes of Indirect Benefits, 11-13

11.29a Foreign Tax Credits, 11-17

**11.30 Employee Expenses, 11-18**

11.31 Employee Expenses, 11-18

11.32 Transportation, 11-20

11.33 Moving Expenses, 11-22

**11.34 Self-Employed, 11-23**

11.35 Self-Employed Income, 11-23

11.36 Self-Employed Expenses, 11-23

11.37 Self-Employed Health Insurance, 11-23

11.38 Self-Employed Retirement, 11-23

11.39 Self-Employed Social Security, 11-23

11.40 Self-Employed Medicare, 11-23

11.41 Self-Employed State Income Tax, 11-23

11.42 Self-Employed State Social Security, 11-23

11.43 Self-Employed State Medicare, 11-23

11.44 Self-Employed State Unemployment Insurance, 11-23

11.45 Self-Employed State Disability Insurance, 11-23

11.46 Self-Employed State Health Insurance, 11-23

11.47 Self-Employed State Life Insurance, 11-23

11.48 Self-Employed State Property Tax, 11-23

11.49 Self-Employed State Sales Tax, 11-23

11.50 Self-Employed State Entertainment Tax, 11-23

11.51 Self-Employed State Gambling Tax, 11-23

11.52 Self-Employed State Other Taxes, 11-23

11.53 Self-Employed State Other Fees, 11-23

11.54 Self-Employed State Other Charges, 11-23

11.55 Self-Employed State Other Penalties, 11-23

11.56 Self-Employed State Other Sanctions, 11-23

11.57 Self-Employed State Other Consequences, 11-23

11.58 Self-Employed State Other Remedies, 11-23

11.59 Self-Employed State Other Procedures, 11-23

11.60 Self-Employed State Other Miscellaneous, 11-23

**TAX TIP** The taxpayer—that's someone who works for the Federal government but doesn't have to take a civil service exam.

**11-10** **EXAMPLE 10** In the current year, Maria travels from Seattle to New York primarily for business. She spends five days conducting business and three days sightseeing and attending seminars. Her employer and her firm reimburse her for her travel and lodging expenses up to \$100 per day. She also deducts her transportation expenses for the business days of business travel from her expenses. Deductible meals are limited to 50% of the actual cost of the meals. Maria's total expenses for the trip are \$1,200. If Maria is an employee, the transportation expenses are deductible only if the trip is primarily for business. If she is a self-employed individual, the transportation expenses are deductible only if the trip is primarily for business. When the trip is made in the United States (foreign travel), special rules apply. Transportation expenses must be allocated between business and personal days unless (1) the taxpayer travels from home for several days or the trip is primarily for business. An aircraft ticket that is used for both business and personal purposes is not deductible.

**11-11** **EXAMPLE 11** In the current year, Robert takes a trip from New York to Japan primarily for business purposes. He is away from home from June 10 through June 18. He spends three days sightseeing and seven days conducting business. He deducts his transportation expenses on both a Friday and a Monday to leave the continental United States. His transportation expenses are \$1,000 per day, and his lodging and incidental expenses are \$200 per day. He also deducts his transportation expenses for the business days of business travel from his expenses. Deductible meals are limited to 50% of the actual cost of the meals. Robert's total expenses for the trip are \$10,000. If Robert is an employee, the transportation expenses are deductible only if the trip is primarily for business. If he is a self-employed individual, the transportation expenses are deductible only if the trip is primarily for business. When the trip is made in the United States (foreign travel), special rules apply. Transportation expenses must be allocated between business and personal days unless (1) the taxpayer travels from home for several days or the trip is primarily for business. An aircraft ticket that is used for both business and personal purposes is not deductible.

**11-12** **EXAMPLE 12** In the current year, Robert takes a trip from New York to Japan primarily for business purposes. He is away from home from June 10 through June 18. He spends three days sightseeing and seven days conducting business. He deducts his transportation expenses on both a Friday and a Monday to leave the continental United States. His transportation expenses are \$1,000 per day, and his lodging and incidental expenses are \$200 per day. He also deducts his transportation expenses for the business days of business travel from his expenses. Deductible meals are limited to 50% of the actual cost of the meals. Robert's total expenses for the trip are \$10,000. If Robert is an employee, the transportation expenses are deductible only if the trip is primarily for business. If he is a self-employed individual, the transportation expenses are deductible only if the trip is primarily for business. When the trip is made in the United States (foreign travel), special rules apply. Transportation expenses must be allocated between business and personal days unless (1) the taxpayer travels from home for several days or the trip is primarily for business. An aircraft ticket that is used for both business and personal purposes is not deductible.

**TAX PLANNING STRATEGIES: Transportation and Travel Expenses**

**FRAMEWORK FOCUS: DEDUCTIONS**

**Advantage: Maintains Deductible Amounts.**

Although deductible amounts of transportation and travel expenses should be high, because the automatic mileage reimbursement often is modest in amount, a more or partial reimbursement used generally for business may generate a higher expense based on actual miles. The election to expense part of the cost of the automobile under § 179, the accelerated depreciation, repair and maintenance, and other provisions, and other related costs may result in a higher expense than the automatic mileage reimbursement. If a taxpayer wants to optimize on a business trip, it would be beneficial to schedule business on both a Friday and a Monday to leave the continental United States. Any allocation purposes, it is especially crucial to schedule appropriate business days when mileage travel is involved.

**11-13: Moving Expenses**

11-13a: Moving Expenses. If a person is consistent with the requirements of work at a new principal workplace, both employees and self-employed individuals can deduct these expenses. They are eligible for a moving expense deduction, if taxpayer must meet the home, distance, and time tests.

**Distance Test**

To meet the distance test, the taxpayer's new job location must be at least 50 miles farther from the taxpayer's old residence than the old residence was from the former place of employment. In this regard, the location of the new residence is not relevant. This distance is a moving expense deduction for § 179 taxpayers who purchase a new home in the same general area without changing their place of employment and § 122 taxpayers who accept a new job at the same area as their old job.

If an individual is not employed before the move, the new job must be at least 50 miles from the former residence. Concept Summary 11.3 illustrates the application of the distance test.

**Time Test**

To meet the time test, an individual must be employed on a full-time basis in the new location for 12 consecutive months following the move. If the taxpayer is a self-employed individual, he or she must work in the new location for 78 months during the 24 months following the move. The first 30 months must be in the first 12 months. The new law is unchanged if the taxpayer dies, becomes disabled, or is discharged earlier than the full 12-month period required by the employee.

**11-13b: Moving Expenses**

11-13b: Moving Expenses. If a person is consistent with the requirements of work at a new principal workplace, both employees and self-employed individuals can deduct these expenses. They are eligible for a moving expense deduction, if taxpayer must meet the home, distance, and time tests.

- 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.
- Additional concept summaries have been added to provide clarification and simplify difficult tax concepts.

**NEW! COMPUTATIONAL EXERCISES:** Students need lots of practice in computing tax return problems, adjusting rates, etc. We've developed these new exercises to give students practice in calculating the solutions they need to make business decisions.

- Found in end-of-chapter section in the textbook
- CengageNOW provides additional algorithmic versions of these problems

### Computational Exercises

16. **LO.1** Sally owns real property for which the annual property taxes are \$8,000. She sells the property to Shelley on February 28, 2015, for \$550,000. Shelley pays the real property taxes for the entire year on October 1.
- How much of the property taxes can be deducted by Sally and how much by Shelley?
  - What effect does the property tax apportionment have on Shelley's adjusted basis in the property?
  - What effect does the apportionment have on Sally's amount realized from the sale?
  - How would the answers in (b) and (c) differ if the taxes were paid by Sally?
17. **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?
18. **LO.1** On July 1, 2015, 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 6%. The market rate of interest is 2%.

**NEW! ROGER CPA EXAM REVIEW QUESTIONS:** While the SWFT series has always provided the most in-depth coverage of tax concepts, Roger CPA Exam Review questions have been added to further prepare students for success on the CPA Exam.

- Located in selected end-of-chapter sections
- Tagged by concept in CengageNOW
- Similar questions to what students would actually find on the CPA exam



### Roger CPA Review Questions

- In the current year, Harper, a married taxpayer filing jointly, sustained an \$82,000 loss on Code Sec. 1244 stock in WWW Corp., a qualifying small business corporation, and a \$27,000 loss on Code Sec. 1244 stock in RRR Corp., another qualifying small business corporation. What is the maximum amount of loss that Harper can deduct for the current year?
  - \$106,000 capital loss and \$3,000 ordinary loss.
  - \$9,000 ordinary loss and \$100,000 capital loss.
  - \$100,000 ordinary loss and \$9,000 capital loss.
  - \$109,000 capital loss.
- In Year 1 Keller, an individual, purchased depreciable real property for \$80,000. In Year 5 Keller sold the property for \$100,000. At the time of sale the property had a basis of \$30,000 due to \$50,000 depreciation taken during the holding period. Of the

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

## THE BIG PICTURE

### CONVERTING A C CORPORATION TO AN S CORPORATION

Fowle, Inc., has been operating as a C corporation for a number of years, consistently earning taxable income of less than \$100,000 per year. The company has accumulated its earnings for a variety of business needs and has not paid dividends to date. Thus, the corporation has been able to take advantage of lower C corporation tax rates and has avoided double taxation problems so far.

Fowle receives some tax-exempt income, generates a small domestic production activities deduction (DPAD), and holds about \$200,000 of C corporation earnings and profits. The company's sole owner, David, currently draws a salary of \$92,000. Fowle has issued two classes of stock, voting common and non-voting preferred.

The company now is facing increased competition as a result of cheaper imports from China. David expects very large operating losses for the next few years. David would like to know if there is a way that he can deduct the anticipated losses.

*Read the chapter and formulate your response.*

## THE BIG PICTURE: Tax Solutions for the Real World.

Taxation comes alive at the start of each chapter as The Big Picture Examples give a glimpse into the lives, families, careers, and tax situations of typical individual or business filers. Students will follow the family, individual, or other taxpayer throughout the chapter showing students how the concept they are learning plays out 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 apply the concepts and topics from the chapter in a reasonable and professional way.

## BRIDGE DISCIPLINE BOXES AND END-OF-CHAPTER QUESTIONS:

**Bridge Discipline Boxes** throughout the text present material and concepts from other disciplines such as economics, financial accounting, and finance. They help to bridge the gap between taxation issues and issues raised in other business courses. **Bridge Discipline Questions**, in the end-of-chapter material, help test these concepts and give students the chance to apply concepts they've learned in the Bridge Discipline boxes.



### BRIDGE DISCIPLINE Bridge to Investments

Most investors look to the stocks of utilities, real estate investment trusts, and tobacco companies as the source of steady dividend payments. This is a prudent decision on the investor's part, as the typical S&P 500 stock offers a dividend yield of about 2 percent. But an investor could put together an effective portfolio using only stocks and mutual funds that regularly produce higher dividend yields.

Dividends can be important to the investor because:

- They can be used in a tax-sheltered account, like a 529 plan, such that the tax inefficiency of the dividends is not recognized immediately by the investor.

- Even today, about 40 percent of the total return from an investment can be traced to holding stocks that make regular distributions.
- Generally, a dividend-paying company is a profitable company, and corporate profits often are hard to come by.
- Earning and reinvesting dividends is an easy way to put into place an investment policy of dollar-cost averaging, a technique that forces the investor to buy more shares when prices are low and fewer shares when prices are high. Dollar-cost averaging often implements a contrarian investment strategy.



### FINANCIAL DISCLOSURE INSIGHTS Effective Tax Strategies Using Overseas Operations

In a global economy, publicly traded business entities can operate in many taxing jurisdictions. For instance, General Electric reports that it files current-year tax returns with more than 250 countries, amounting to over 7,000 income tax returns at the Federal and local levels worldwide. Note that this tax activity does not take into account the sales, value added, property, and other tax returns that are required by the U.S. states and localities.

The financial reports of profitable U.S. companies indicate that overseas operations can produce tax benefits of their own, not taking into account the effects of

increased market share and financial stability. For instance, the trucking firm Ryder Systems recently reported current tax refunds of about \$235,000 and deferred tax savings of about \$500,000 on non-U.S. profits of about \$11.5 million.

In a recent period, Eli Lilly reduced its effective tax rate by about one-third due to overseas operations. And General Electric recently reduced its effective tax rate to a negative amount because of various income deferrals related to overseas earnings. These deferral techniques are discussed later in the chapter.

## FINANCIAL DISCLOSURE INSIGHTS:

Tax professionals need to understand how taxes affect the income statement and balance sheet. **Financial Disclosure Insights**, appearing throughout the text, use current data about existing taxpayers to highlight book-tax reporting differences, effective tax rates, and trends in reporting conventions.

**TAX IN THE NEWS:** Drawn from today's business and popular press, **Tax in the News** features enliven class discussions by presenting current issues that illustrate the chapter material and applying them to real life.



### TAX IN THE NEWS So Where Did You Work Today?

The dream of many intellectual-property employees is to work at home with the employer's computer and communications equipment. Not only is the dress code there targeted to the worker's comfort, but the employee can avoid the time and cost of commuting. The employer saves by not having to provide office space.

But what are the tax effects when the employee or independent contractor submits work to an employer located in a

different state? The general rule has been that state income taxes fall in full in the state where the work is done. Is this still the rule, or must the employee apportion the hours of the day among the various states that receive the work product? If so, on what basis should such apportionment be made? Furthermore, how will the worker reduce any potential taxation of the same income by more than one state?



## TAX PLANNING FRAMEWORK:

To demonstrate the relevance of tax planning for business and individual taxpayers, *Essentials of Taxation: Individuals and Business Entities* presents a unique **tax planning framework**.

Introduced in Chapter 1, this framework extends to a series of **Tax Planning Strategies** incorporated throughout the remainder of the text. The inclusion of the tax planning framework, and the planning strategies in each chapter, makes it easier than ever to understand the impact careful tax planning has in today's world.

EXHIBIT 1.3 General Framework for Income Tax Planning

Tax Formula	Tax Planning Strategy	Tax Planning Examples
Income and exclusions	➤ Avoid income recognition. ➤ Postpone recognition of income to achieve tax deferral.	Compensate employees with nontaxable fringe benefits (see Example 19). Postpone sale of assets (see Example 20).

### TAX PLANNING STRATEGIES Property from a Decedent

#### FRAMEWORK FOCUS: INCOME

Strategy: Avoid Income Recognition.

#### FRAMEWORK FOCUS: DEDUCTIONS

Strategy: Maximize Deductible Amounts.

If a taxpayer retains appreciated property until death, the property's basis will be "stepped up" to its fair market value at that time. Thus, no income tax will be paid on the property's appreciation by either the former owner (the decedent) or the new owner (the heir).

On the other hand, depreciated property should be sold prior to death. Otherwise, the property's basis in the heir's hands will be its declined fair market value, and neither the decedent nor the heir will be able to deduct the loss that occurred while the property was owned by the decedent.

**TAX PLANNING STRATEGIES:** The tax planning framework extends to subsequent chapters as **Tax Planning Strategies boxes** that are tied to the topical coverage of the chapters. Planning Strategies often contain examples to further illustrate the concept for students. Because some tax planning strategies do not fit neatly into the framework, the text also provides tax planning strategies called **Thinking Outside the Framework**.

**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.

### GLOBAL TAX ISSUES Deferral and Repatriation

U.S. taxpayers with foreign operations have a choice as to how they structure such operations for U.S. tax purposes. If the U.S. taxpayer operates through an unincorporated foreign branch, the net profits from the foreign branch are subject to current taxation in the U.S. tax return of the U.S. taxpayer.

If instead the U.S. taxpayer operates abroad through a separate wholly owned foreign corporation, the income from the foreign operation is deferred from U.S. taxation until the profits are repatriated back to the United States

(via a dividend or similar distribution) or when they are treated as repatriated through the operation of the Subpart F deemed dividend provisions (as discussed later). This option can have a significant effect on a U.S. taxpayer's current-period tax burden, particularly if the foreign operations are in a lower-tax jurisdiction.

As discussed in Chapter 3, under ASC 740 (APB 23), this deferral of taxes also can reduce the financial statement tax expense if the offshore profits are indefinitely reinvested outside the United States.

#### DIGGING DEEPER 1

In-depth coverage can be found on this book's companion website: [www.cengagebrain.com](http://www.cengagebrain.com)

**DIGGING DEEPER:** Designed to help students go further in their knowledge of certain topics, **Digging Deeper** links within the text that provide more in-depth coverage can be found on the book's website at [www.cengagebrain.com](http://www.cengagebrain.com).

# Take your students from Motivation to Mastery with CengageNOW

CengageNOW 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.

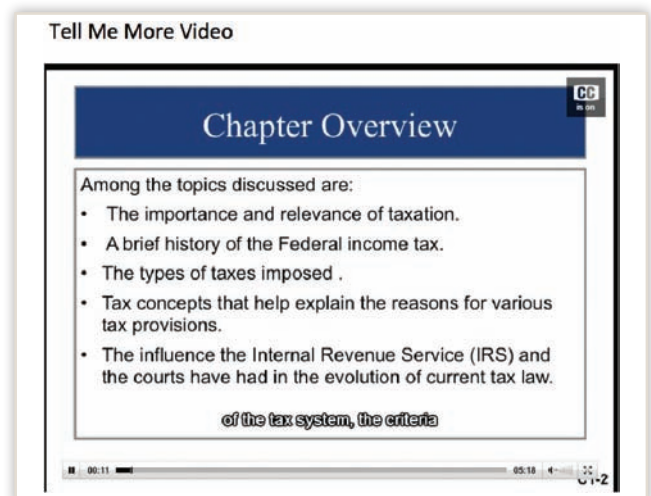


- **MOTIVATION:** engage students and better prepare them for class
- **APPLICATION:** help students learn problem-solving behavior and skills in order to complete taxation problems on their own
- **MASTERY:** help students make the leap from memorizing concepts to actual critical thinking

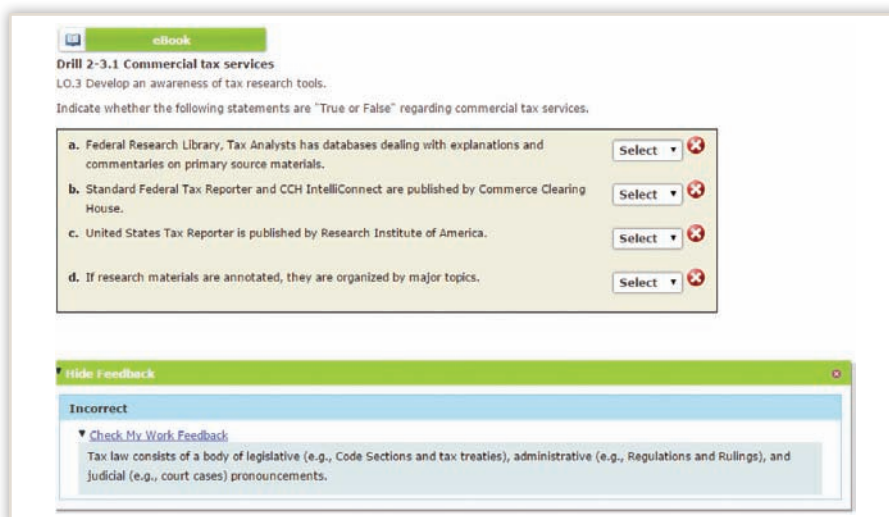
## Motivation —

Many instructors find that students come to class unmotivated and unprepared. To help with engagement and preparedness, CengageNOW for SWFT offers the following features:

- **“Tell Me More” videos provide a summary of the chapter at a glance.** These videos help students become familiar with key terms and concepts presented in each chapter, prior to class lectures.
- **“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 —



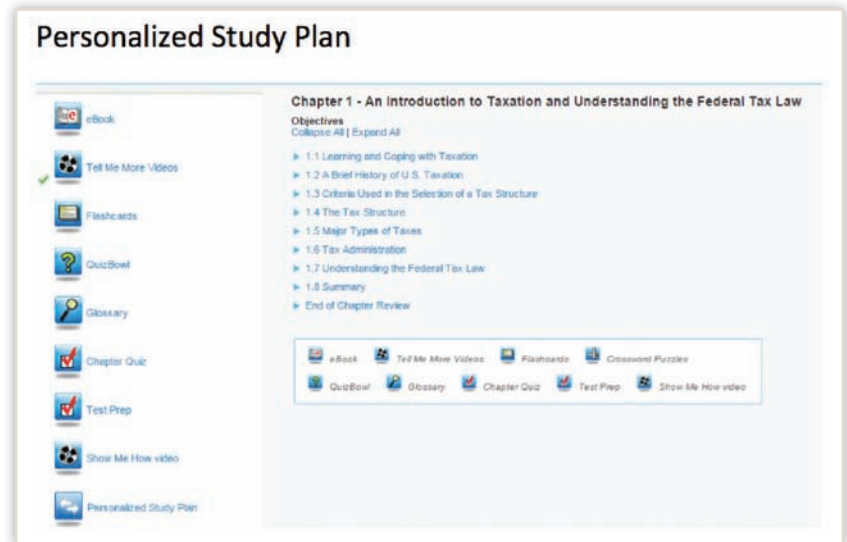
Students need to learn problem-solving behavior and skills in order to complete taxation problems on their own. However, as students try to work through homework problems, sometimes they become stuck and need guidance. To help reinforce concepts and keep students on the right track, CengageNOW for SWFT 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 —

- **“What-If” versions of problems** allow students to develop a deeper understanding of the material as they are challenged to use their prior knowledge of the tax situations and critically think through new attributes to determine how the outcome will change.
- **Personalized Study Plan.** Complete with pre-tests, post-tests, an eBook, and practice quizzes. Designed to help give students additional support and prepare them for the exam.



**CengageNOW Instant Access Code ISBN: 978-1-305-39542-8**

Contact your Cengage Learning Consultant about different bundle options.



## 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 of the chapters up to date and accurate. All chapters of *Essentials of Taxation: Individuals and Business Entities* contain the following general changes for the 2016 Edition.

- 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. Added Computational Exercises and CPA Exam problems for additional skill-building by the reader.
- Updated *Tax in the News* items with coverage of recent events.
- Added guideposts to make Examples easier to use.
- 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.

### Chapter 1

- Updated materials to reflect inflation indexation, including the unified transfer tax credit and exemption amount, annual gift tax exclusion amount, and FICA base amount.
- Updated statistics about Federal income tax paid by income classes, Federal budget receipts and collections, national excise taxes on gasoline and cigarettes consumption, and Tax Freedom Day.
- Revised the Concept Summary on the major types of taxes imposed in the United States and the political jurisdictions that impose these taxes.

### Chapter 2

- Updated references and citations throughout the chapter.
- Revised and clarified text and examples throughout the chapter.

### Chapter 3

- Revised the discussion of Schedule M–3.
- Revised and updated the discussion of Schedule UTP.
- Modified or updated various *Financial Disclosure Insights*, *Global Tax Issues*, and *Tax in the News* items and added a *Tax in the News* item (“The APB 23 Deferral”).
- Revised and clarified text and examples throughout the chapter.

### Chapter 4

- Included a *Global Tax Issues* item about the trend of corporate inversions and individuals renouncing their U.S. citizenship.
- Clarified accrual and hybrid methods of accounting and made comparisons to financial reporting rules.
- Clarified the discussion on the methods regarding adoption and use of Rev.Proc. 2004–34.
- Added a Concept Summary for income recognition rules.
- Included additional references regarding when an individual must also consider the NIIT, including for planning.
- Added a research problem involving virtual currency.

### Chapter 5

- Revised and clarified text and examples throughout the chapter.
- Modified material to reflect annual indexation for inflation.
- Streamlined material on MACRS special rules and amortization.
- Updated materials to reflect tax extender legislation involving additional first-year depreciation and § 179 expense election.

## Chapter 6

- Added a *Tax in the News* item about Notice 2014–21 and lost bitcoins.
- Simplified the discussion of NOLs.
- Added a Concept Summary on at-risk and passive loss limitation rules.

## Chapter 7

- Added a discussion of the tax implications of virtual currency (bitcoin) and related IRS Notice 2014–21.
- Clarified discussion of the holding period for gifted property and property acquired from a decedent.
- Updated the *Tax in the News* item related to cost basis reporting.
- Simplified discussion and examples related to like-kind exchanges.
- Revised and clarified text and examples throughout the chapter.

## Chapter 8

- Revised and clarified text and examples throughout the chapter.
- Modified or updated various *Global Tax Issues* and *Tax in the News* items.
- Revised and updated chapter Concept Summaries.

## Chapter 9

- Made updates for inflation adjustments.
- Separated the discussion of tax determinations and filing procedures.
- Added a discussion on the basics of NIIT and the Additional Medicare Tax, as well as an example and exercise.

## Chapter 10

- Made updates for inflation adjustments.
- Added a discussion on the basics of the Affordable Care Act's Premium Tax Credit and Individual Shared Responsibility Payment.

## Chapter 11

- Updated materials to reflect inflation indexation.
- Revised and clarified text and examples throughout the chapter.
- Updated various computational formulas and amounts.

- Added a Concept Summary identifying and describing key employee fringe benefits.
- Added a Concept Summary about moving expenses.
- Simplified the summary dealing with the many tax provisions involving education.
- Added a Concept Summary comparing Traditional and Roth IRAs.
- Added a discussion of IRA rollovers and conversions.

## Chapter 12

- Added a Concept Summary that illustrates the major shareholder consequences of a taxable property transaction as compared to one that is tax deferred under § 351.
- Added a Concept Summary that shows the tax rules that apply when liabilities are transferred in property transactions, including the special rules that apply in a § 351 transaction.
- Provided a new *Tax in the News* item that describes ways in which local and state jurisdictions compete to attract new businesses and employers in exchange for tax breaks.
- Revised and clarified text and examples throughout the chapter.

## Chapter 13

- Updated statistics as to the amount of annual corporate distributions and the entities that make the distributions.
- Added an example illustrating regular tax and E & P timing and accounting method adjustments.
- Added an example clarifying the treatment given to § 179 under the regular tax and E & P rules.
- Revised a *Bridge to Finance* item and the stock redemption materials.

## Chapter 14

- Added comments about the breadth and the use of pass-through entities in the U.S. economy.
- Revised the discussion of LLPs and LLCs and their advantages and disadvantages.
- Enhanced the discussion of the Medicare surtax and the net investment income tax (NIIT) applicable to certain higher-income taxpayers who have interests in partnerships and limited liability entities.

## Chapter 15

- Updated statistics as to S corporation and LLC Federal income tax filings.
- Reorganized the discussion providing the overview and advantages of S corporation status.
- Clarified the discussion as to those entities that qualify as small business corporations.
- Enhanced coverage of *The Big Picture* scenario within the text discussion.
- Revised the discussion of entity-level taxes.

## Chapter 16

- Revised and clarified text and examples throughout the chapter.
- Revised introductory statistics about the global economy and updated various indexed amounts and limitations.
- Updated statistics as to the combined income tax rates of various countries, including the United States.
- Expanded materials about how FATCA affects overseas investors and financial institutions.
- Updated statistics about the use of the foreign tax credit and about the tax returns of non-U.S. persons who generate U.S. taxable income.
- Updated statistics about the tax collections of the U.S. states.
- Modified the *Tax in the News* item “So Where Did You Work Today?”
- Added a new *Bridge to Economic Development and Political Science* feature.

## Chapter 17

- Revised and clarified text and examples throughout the chapter.
- Added materials on small employer health insurance credit.
- Reordered AMT coverage and added discussion of circulation expenditures adjustment, intangible drilling costs preference, and AMT NOLs.
- Updated individual AMT information for inflation adjustments.

## Chapter 18

- Reorganized the initial discussion about how to choose a tax-effective form of doing business, especially as to avoiding the double taxation of business income.
- Emphasized how nontax factors, especially limited liability, affect the entity choice.
- Reorganized the discussion of how the choices of entity differ as to the conduit and entity concepts of taxation.
- Expanded the material as to how best to distribute profits from an entity to its owners.
- Expanded the discussion of how the at-risk and passive activity rules can affect the entity choice.
- Expanded the discussion of differences of asset and entity sales when disposing of a business.
- Showed the effect of the net investment income tax (NIIT) on the choice of business entities.
- Simplified the Concept Summaries that compared the tax attributes of the different types of entities.

## TAX LAW OUTLOOK

### *From your SWFT Series Editors:*

Concerns about income inequity and job creation will keep income tax issues at the forefront of Congressional discussions throughout 2015 and 2016. Revenue raisers of all sorts will be considered as Federal budgets are crafted, including those to support the retirement and health care systems. Federal tax treatments of income from overseas sources also may be reviewed. While a comprehensive “tax reform” bill is not likely, there will be serious consideration of various proposals throughout the year involving broad-based tax changes. Expect provisions to be considered involving child tax credits and tax incentives for education, as well as other items to help middle-class taxpayers. Most likely the tax provisions that expired in 2014 will be extended to 2015 on a retroactive basis.

Congress may consider Federal corporate tax law changes during 2015–2016, including a decrease in the top tax rate and a move toward a territorial system in taxing income from overseas sources. Tax deferrals for unrepatriated global profits also may receive Congressional attention. State and local governments also have budget problems, and they are looking for new revenue sources, including an adoption of the unitary concept and a broadening of the income and sales/use tax bases.



## 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



CengageNOW 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.

**CengageNOW Instant Access Code ISBN:**  
978-1-305-39542-8

Contact your Cengage Learning Consultant about different bundle options.

THOMSON REUTERS

**CHECKPOINT**  
Student Edition

**Checkpoint® Student Edition from Thomson Reuters** is the leading

online tax research database used by professionals. There are three simple ways Checkpoint helps introduce students to tax research:

- 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 Student Edition (after activation) is packaged automatically with every NEW copy of the textbook.\*



More than software: Put the experience of H&R Block tax professionals on your side.

- A step-by-step interview guides you through a customized process.
- Accurate calculations and 100% satisfaction—guaranteed.

\* Checkpoint® Student Edition is not available with the Professional Editions of South-Western Federal Taxation texts. For all other editions, all NEW printed copies of the textbook are automatically packaged with Checkpoint Student Edition and H&R Block® tax software. If students purchase the eBook, they will not automatically receive access to Checkpoint Student Edition and H&R Block software. They must purchase the tax media pack offering both of these products. The ISBN is 978-1-285-44270-9 and can be purchased at [www.cengagebrain.com](http://www.cengagebrain.com).

- Worry-free Audit Support™ and tax advice from an H&R Block tax professional.

A H&R Block® Premium & Business software CD is offered with each NEW copy of the textbook—at no additional cost to students\*.

**CENGAGEbrain.com** Students can use **CengageBrain.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 **CengageBrain.com**.

### Online Student Resources

Students can go to [www.cengagebrain.com](http://www.cengagebrain.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.

### Printed Resources for Students

#### Looseleaf Edition (978-1-305-39533-6)

This version provides all the pages of the text in an unbound, three-hole punched format for portability and ease of use. A H&R Block® Premium & Business software CD is included with every NEW textbook as well as Checkpoint® Student Edition from Thomson Reuters.\*

## Comprehensive Supplements Support Instructors' Needs



CengageNOW 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, CengageNOW 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 have been imported into CengageNOW so that they may be used as additional homework or tests.

### Solutions Manual (978-1-305-39540-4)

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 lettered answers (only) to the end-of-chapter Roger CPA Review Questions. **Available in print and on Instructor Companion Website at [www.cengage.com/login](http://www.cengage.com/login).**

### PowerPoint® Lectures

The Instructor PowerPoint Lectures contain more than 30 slides per chapter, including outlines and instructor guides, concept definitions, alternate figures, and key points. **Available on 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 2016 Test Bank is available in Cengage's new 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, along with versions to import into your LMS, available on Instructor Companion Website. Cognero Test Banks available via Single Sign-on account at [www.cengage.com/login](http://www.cengage.com/login).**

**All instructor course materials are posted 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.

- Solutions Manual
- Detailed answer feedback for the end-of-chapter Roger CPA Review questions in Word format. (Lettered answers only are available in the Solutions Manual.)
- Additional Test Bank items and solutions
- PowerPoint Lectures

### 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 2016 Edition*:

- Remove chapters you do not cover or rearrange their order to create a streamlined and efficient text.
- Add your own material to cover new topics or information.
- Add relevance by including sections from Smith's *Internal Revenue Code and Regulations*, Raabe/Whittenburg/Sanders/Sawyers' *Federal Tax Research*, or your state's tax laws and regulations.

\* Checkpoint® Student Edition is not available with the Professional Editions of South-Western Federal Taxation.

## ACKNOWLEDGMENTS

We want to thank all the adopters and non-adopters 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** 2016 titles:

- Deborah S. Adkins, *Nperspective, LLC*  
 Amy An, *University of Iowa*  
 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, *LeMoyné College*  
 John G. Bell  
 Tamara Berges, *UCLA*  
 Ellen Best, *University of North Georgia*  
 Tim Biggart, *Berry College*  
 Rachel Birkey, *Illinois State University*  
 Chris E. Bjornson, *Indiana University Southeast*  
 Patrick M. Borja, *Citrus College / California State University, Los Angeles*  
 Dianne H. Boseman, *Nash Community College*  
 Cathalene Bowler, *University of Northern Iowa*  
 Darryl L. Brown, *Illinois Wesleyan University*  
 Timothy G. Bryan, *University of Southern Indiana*  
 Robert S. Burdette, *Salt Lake Community College*  
 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*  
 James Milton Christianson, *Southwestern University and Austin Community College*  
 Ann Burstein Cohen, *University at Buffalo, The State University of New York*  
 Ciril Cohen, *Fairleigh Dickinson University*  
 Dixon H. Cooper, *University of Arkansas*  
 Bradrick Cripe, *Northern Illinois University*  
 Rick L. Crosser, *Metropolitan State University of Denver*  
 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*  
 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*  
 Dr. Rafi Efrat, *California State University, Northridge*  
 Elizabeth C. Ekmekjian, *William Paterson University*  
 Charles R. Enis, *The Pennsylvania State University*  
 Frank J. Faber  
 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*  
 Stephen C. Gara, *Drake University*  
 Sheri Geddes, *Hope College*  
 Alexander Gelardi, *University of St. Thomas*  
 Daniel J. Gibbons, *Waubensee Community College*  
 Martie Gillen, *University of Florida*  
 Charles Gnizak, *Fort Hays State University*  
 Prof. J. David Golub, *Northeastern University*  
 George G. Goodrich, *John Carroll University*  
 Dr. Marina Grau, *Houston Community College – Houston TX*  
 Vicki Greshik, *University of Jamestown College*  
 Jeffrey S. Haig, *Santa Monica College*  
 Marcy S. Hampton, *University of Central Florida*  
 June Hanson, *Upper Iowa University*  
 Mary Ann Hofmann, *Appalachian State University*  
 Susanne Holloway, *Salisbury University*  
 Susan A. Honig, *Herbert H. Lehman College*  
 Christopher R. Hoyt, *University of Missouri (Kansas City) School of Law*  
 Marsha M. Huber, *Youngstown State University*  
 Carol Hughes, *Asheville-Buncombe Technical Community College*  
 Dr. Helen Hurwitz, *Saint Louis University*  
 Richard R. Hutaff, *Wingate University*  
 Zite Hutton, *Western Washington University*  
 Debra M. Johnson, *Montana State University Billings*  
 Brad Van Kalsbeek, *University of Sioux Falls*  
 John E. Karayan, *Woodbury University*  
 Cynthia Khanlarian, *Concord University*  
 Bob Kilpatrick, *Northern Arizona University*  
 Gordon Klein, *Lecturer, UCLA Anderson School*  
 Taylor Klett, *Sam Houston State University*  
 Aaron P. Knappe, *Peru State College*  
 Ausher M. B. Kofsky, *Western New England University*  
 Emil Koren, *Saint Leo University*  
 Timothy R. Koski, *Middle Tennessee State University*  
 Sandra Kranz, *Bemidji State University*  
 Jack Lachman, *Brooklyn COLLEGE-CUNY*  
 Richard S. Leaman, *University of Denver*  
 Gene Levitt, *Mayville State University*  
 Stephanie Lewis, *The Ohio State University*  
 Teresa Lightner, *University of North Texas*  
 Sara Linton, *Roosevelt University*  
 Jane Livingstone, *Western Carolina University*  
 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*  
 Anthony Masino, *East Tennessee State University*  
 Bruce W. McClain, *Cleveland State University*  
 Allison M. McLeod, *University of North Texas*  
 Meredith A. Menden, *Southern New Hampshire University*



- John G. Miller, *Skyline College*  
 Lisa Nash, *CPA, MA, Vincennes University*  
 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*  
 Nichole L. Pendleton, *Friends University*  
 Mark Persellin, *St. Mary's University*  
 Chuck Pier, *Angelo State University*  
 Lincoln M. Pinto, *DeVry University*  
 Sonja Pippin, *University of Nevada – Reno*  
 Steve Platau, *The University of Tampa*  
 Walfyette Powell, *Strayer University*  
 John S. Repsis, *University of Texas at Arlington*  
 John D. Rice, *Trinity University*  
 Randall Rinke, *Mercyhurst University*  
 Jennifer Hardwick Robinson, *Trident Technical College*  
 Shani N. Robinson, *Sam Houston State University*  
 Ray Rodriguez, *Murray State University*  
 Richard L. Russell, *Jackson State University*  
 Robert L. Salyer, *Northern Kentucky University*  
 Rhoda Sautner, *University of Mary*  
 Dr. Bunney L. Schmidt, *Keiser University*  
 Eric D. Schwartz, *LaRoche College*  
 Tony L. Scott, *Norwalk Community College*  
 Randy Serrett, *University of Houston – Downtown*  
 Paul Shoemaker, *University of Nebraska – Lincoln*  
 Kimberly Sipes, *Kentucky State University*  
 Georgi Smatrakalev, *Florida Atlantic University*  
 Leslie S. Sobol, *California State University Northridge*  
 Marc Spiegel, *University of California, Irvine*  
 Jason W. Stanfield, *Purdue University*  
 George Starbuck, *McMurry University*  
 Teresa Stephenson, *University of Wyoming*  
 Beth Stetson, *Oklahoma City University*  
 Frances A. Stott, *Bowling Green State University*  
 Todd S. Stowe, *Southwest Florida 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*  
 Ralph Tower, *Wake Forest (Retired)*  
 James P. Trebby, *Marquette University*  
 Donald R. Trippeer, *State University of New York College at Oneonta*  
 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*  
 Marie Wang  
 Natasha R. Ware, *Southeastern University*  
 Sarah Webber, *University of Dayton*  
 Bill Weispfenning, *University of Jamestown (ND)*  
 Andrew Whitehair  
 Kent Williams, *Indiana Wesleyan University*  
 Marvin Williams, *University of Houston-Downtown*  
 Candace Witherspoon, *Valdosta State University*  
 Sheila Woods, *DeVry University, Houston, TX*

## 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, comprehensive tax form problems, and practice sets. Their comments and corrections helped us focus on clarity as well as accuracy and tax law currency. They are **Sandra A. Augustine**, Hilbert College; **Chris E. Bjornson**, Indiana University Southeast; **Bradrick M. Cripe**, Northern Illinois University; **Eileen Eichler**, Farmingdale State College; **Elizabeth C. Ekmekjian**, William Paterson University; **Stephen C. Gara**, Drake University; **Mary Ann Hofmann**, Appalachian State University; **Debra M. Johnson**, Montana State University, Billings; **Timothy R. Koski**, Middle Tennessee State University; **Sandra J. Kranz**, Bemidji State University; **Stephanie Lewis**, The Ohio State University; **Joan M. Miller**, William Paterson

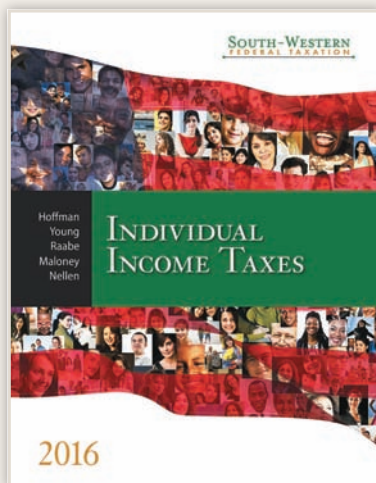
University; **Randall Rinke**, Mercyhurst University – North East Campus; **Ray Rodriguez**, Southern Illinois University, Carbondale; **Lucia N. Smeal**, Georgia State University; **Eric Smith**, Weber State University; **Jason W. Stanfield**, Purdue University; **George R. Starbuck**, McMurry University; **Kent Swift**, University of Montana; **Ralph B. Tower**, Wake Forest University; **Donald R. Trippeer**, State University of New York College at Oneonta; **Raymond Wacker**, Southern Illinois University, Carbondale; **Sarah Webber**, University of Dayton; **Michael Weissenfluh**, Tillamook Bay Community College; **Marvin J. Williams**, University of Houston, Downtown; **Scott A. Yetmar**, Cleveland State University. We are grateful for their efforts.

We are also grateful for the editorial assistance of **Bonnie Hoffman**, CPA on many of the chapters. We also wish to thank Thomson Reuters for its permission to use Checkpoint with the text.

*William A. Raabe / David M. Maloney / James C. Young / James E. Smith / Annette Nellen*

# The South-Western Federal Taxation Series

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



## INDIVIDUAL INCOME TAXES, 2016 EDITION

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

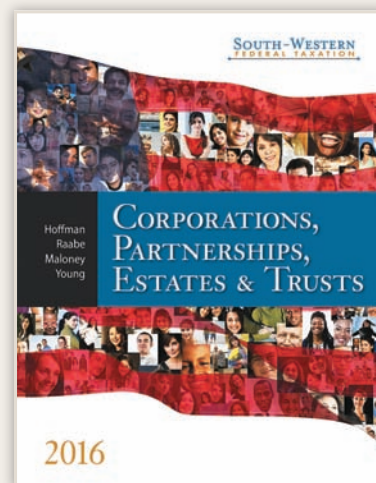
provides accessible, comprehensive, and authoritative coverage of the relevant tax code and regulations as they pertain to the individual taxpayer, as well as coverage of all major developments in Federal taxation.

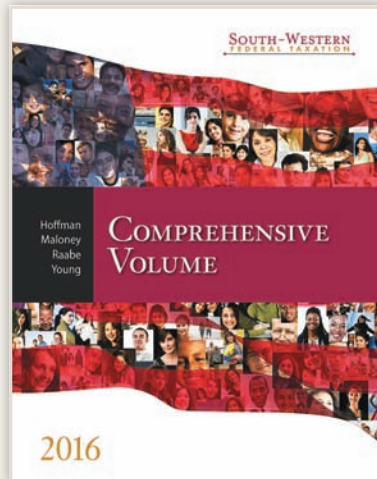
**(ISBN 978-1-305-39330-1)**

## CORPORATIONS, PARTNERSHIPS, ESTATES & TRUSTS, 2016 EDITION

**(HOFFMAN, RAABE, MALONEY, YOUNG, 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. The text includes **Chapter 14, "Taxes on the Financial Statements."**

**(ISBN 978-1-305-39988-4)**





## COMPREHENSIVE VOLUME, 2016 EDITION

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

Combining the number one individual tax text with the number one corporations text, *Comprehensive Volume, 2016 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.

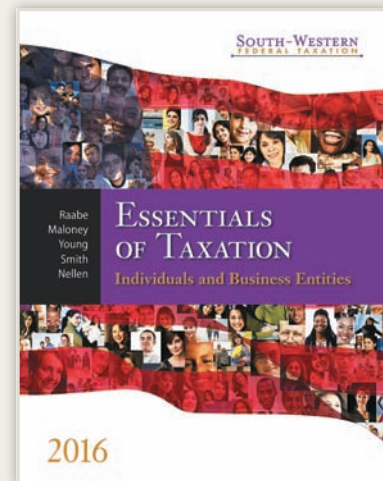
**(ISBN 978-1-305-39511-4)**

## ESSENTIALS OF TAXATION: INDIVIDUALS & BUSINESS ENTITIES, 2016 EDITION

**(RAABE, MALONEY, YOUNG, SMITH, NELLEN, Editors)**

emphasizes tax planning and the multidisciplinary aspects of taxation. Formerly titled *Taxation of Business Entities*, 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 978-1-305-39530-5)**

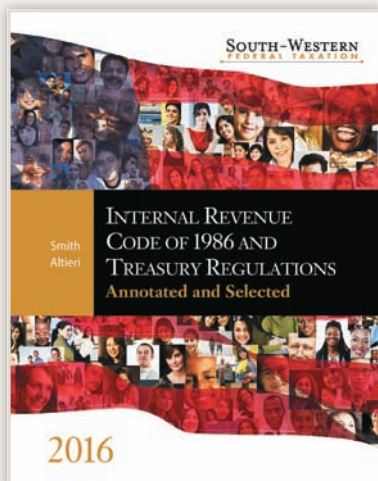


## INTERNAL REVENUE CODE OF 1986 AND TREASURY REGULATIONS

*Annotated and Selected, 2016 Edition*

**(JAMES E. SMITH, MARK ALTIERI)** An ideal alternative to the traditional, bulky, and expensive multivolume set of code and regulations, this single-volume reference provides a useful selection of code and regulations sections and clear annotations in the form of editorial summaries that explain, analyze, and cross-reference topics to help students fully understand the intricacies of the tax code. The text is a perfect supplement for any **South-Western Federal Taxation** text as well as an excellent primary text for a Federal taxation course that stresses a code and regulations approach.

**2016 Edition coming in July 2015 (ISBN 978-1-305-66065-6)**



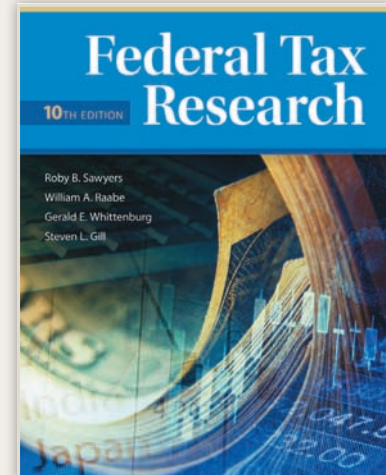


## FEDERAL TAX RESEARCH, 10E

**(RAABE, WHITTENBURG, SANDERS, AND SAWYERS)**

*Federal Tax Research*, Tenth Edition, offers hands-on tax research analysis and fully covers computer-oriented tax research tools. The tenth edition offers a new chapter on Financial Accounting Research that, when combined with their study of tax research, will equip students with the valuable research skills they need to be marketable to future employers. Also included in this edition is coverage on international tax research, an expanded review of tax ethics, and many new real-life cases to help foster a true understanding of federal tax law.

**(ISBN 978-1-285-43939-6)**



## ABOUT THE EDITORS



**William A. Raabe, Ph.D., CPA**, is the Distinguished Professor of Accounting in the College of Business and Economics of the University of Wisconsin–Whitewater. A graduate of Carroll University (Wisconsin) and the University of Illinois, Dr. Raabe's teaching and research interests include

international and multistate taxation, technology in tax education, personal financial planning, and the economic impact of sports teams and fine arts groups. Dr. Raabe also writes *Federal Tax Research* and the PricewaterhouseCoopers Tax Case Studies. He has written extensively about book-tax differences in financial reporting. Dr. Raabe has been a visiting tax faculty member for a number of public accounting firms, bar associations, and CPA societies. He has received numerous teaching awards, including the Accounting Educator of the Year award from the Wisconsin Institute of CPAs. He has been the faculty adviser for student teams in the Deloitte Tax Case Competition (national finalists at three different schools) and the PricewaterhouseCoopers Extreme Tax policy competition (national finalist). For more information about Dr. Raabe, visit [BillRaabeTax.com](http://BillRaabeTax.com) and [BillRaabeTax](http://BillRaabeTax) on YouTube and Twitter.



**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*.



**James C. Young** is the Crowe Horwath 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.



**James E. Smith** is the John S. Quinn Professor of Accounting at the College of William and Mary. He has been a member of the Accounting Faculty for over 30 years. He received his Ph.D. degree from the University of Arizona. Professor Smith has served as a discussion leader for

Continuing Professional Education programs for the AICPA, Federal Tax Workshops, and various state CPA societies. He has conducted programs in more than 40 states for approximately 25,000 CPAs. He has been the recipient of the AICPA's Outstanding Discussion Leader Award and the American Taxation Association/Arthur Andersen Teaching Innovation Award. Among his other awards are the Virginia Society of CPAs' Outstanding Accounting Educator Award and the James Madison University's Outstanding Accounting Educator Award. He was the President of the Administrators of Accounting Programs Group (AAPG) in 1991–1992. He was the faculty adviser for the William and Mary teams that received first place in the Andersen Tax Challenge in 1994, 1995, 1997, 2000, and 2001 and in the Deloitte Tax Case Study Competition in 2002, 2004, 2005, 2006, 2008, and 2011.



**Annette Nellen**, CPA, CGMA, Esquire, directs San José State University's graduate tax program (MST) and teaches courses in tax research, tax fundamentals, accounting methods, property transactions, state taxation, employment tax, ethics, 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*, and the *BloombergBNA Internet Law Resource Center*, *Overview of Internet Taxation Issues*. She has published numerous articles in the *AICPA Tax Insider*, *Tax Adviser*, *State Tax Notes*, 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 ([www.21stcenturytaxation.com](http://www.21stcenturytaxation.com)) as well as websites on tax reform and state tax issues ([www.cob.sjsu.edu/nellen\\_a/](http://www.cob.sjsu.edu/nellen_a/)).



# Brief Contents

## **PART 1: THE WORLD OF TAXATION**

---

CHAPTER 1	INTRODUCTION TO TAXATION	1-1
CHAPTER 2	WORKING WITH THE TAX LAW	2-1
CHAPTER 3	TAXES ON THE FINANCIAL STATEMENTS	3-1

## **PART 2: STRUCTURE OF THE FEDERAL INCOME TAX**

---

CHAPTER 4	GROSS INCOME	4-1
CHAPTER 5	BUSINESS DEDUCTIONS	5-1
CHAPTER 6	LOSSES AND LOSS LIMITATIONS	6-1

## **PART 3: PROPERTY TRANSACTIONS**

---

CHAPTER 7	PROPERTY TRANSACTIONS: BASIS, GAIN AND LOSS, AND NONTAXABLE EXCHANGES	7-1
CHAPTER 8	PROPERTY TRANSACTIONS: CAPITAL GAINS AND LOSSES, SECTION 1231, AND RECAPTURE PROVISIONS	8-1

## **PART 4: TAXATION OF INDIVIDUALS**

---

CHAPTER 9	INDIVIDUALS AS THE TAXPAYER	9-1
CHAPTER 10	INDIVIDUALS: INCOME, DEDUCTIONS, AND CREDITS	10-1
CHAPTER 11	INDIVIDUALS AS EMPLOYEES AND PROPRIETORS	11-1



## **PART 5: BUSINESS ENTITIES**

---

CHAPTER 12	CORPORATIONS: ORGANIZATION, CAPITAL STRUCTURE, AND OPERATING RULES	12-1
CHAPTER 13	CORPORATIONS: EARNINGS & PROFITS AND DISTRIBUTIONS	13-1
CHAPTER 14	PARTNERSHIPS AND LIMITED LIABILITY ENTITIES	14-1
CHAPTER 15	S CORPORATIONS	15-1

## **PART 6: SPECIAL BUSINESS TOPICS**

---

CHAPTER 16	MULTIJURISDICTIONAL TAXATION	16-1
CHAPTER 17	BUSINESS TAX CREDITS AND CORPORATE ALTERNATIVE MINIMUM TAX	17-1
CHAPTER 18	COMPARATIVE FORMS OF DOING BUSINESS	18-1

# Contents

## Part 1: The World of Taxation

### CHAPTER 1

#### INTRODUCTION TO TAXATION 1-1

**The Big Picture:** *A Typical Tax Year for a Modern Family* 1-1

#### THE STRUCTURE OF TAXES 1-2

Tax Rates 1-2

**Tax Fact:** *Carrying the Tax Burden* 1-3

Tax Bases 1-3

Incidence of Taxation 1-3

#### TYPES OF TAXES 1-4

Taxes on the Production and Sale of Goods 1-4

**Global Tax Issues:** *Why Is Gasoline Expensive? It Depends on Where You Live* 1-5

Employment Taxes 1-6

Taxes at Death 1-8

Gift Tax 1-9

Property Taxes 1-10

**Tax Fact:** *A Profile of Tax Collections* 1-11

**Tax in the News:** *The Backdoor Tax Increase* 1-11

Taxes on Privileges and Rights 1-12

Income Taxes 1-12

**Tax Fact:** *What Is the U.S. Tax Burden?* 1-14

**Bridge Discipline:** *Bridge to Political Science and Sociology* 1-15

#### INCOME TAXATION OF BUSINESS ENTITIES 1-15

Proprietorships 1-15

**Financial Disclosure Insights:** *What Do You Mean by "Income" Anyway?* 1-16

C Corporations 1-16

Partnerships 1-16

S Corporations 1-17

Limited Liability Companies and Limited Liability Partnerships 1-17

Dealings between Individuals and Entities 1-17

**Financial Disclosure Insights:** *Book-Tax Differences* 1-18

#### TAX PLANNING FUNDAMENTALS 1-18

Overview of Tax Planning and Ethics 1-18

A General Framework for Income Tax Planning 1-19

Tax Minimization Strategies Related to Income 1-19

Tax Minimization Strategies Related to Deductions 1-21

**Tax Fact:** *The Rewards of Tax Planning* 1-22

Tax Minimization Strategies Related to Tax Rates 1-22

**Tax Fact:** *The U.S. Federal Income Tax* 1-24

Tax Minimization Strategies Related to Credits 1-25

Thinking Outside the Framework 1-25

**Bridge Discipline:** *Bridge to Political Science, Economics, Health Care* 1-27

#### UNDERSTANDING THE FEDERAL TAX LAW 1-27

Revenue Needs 1-27

Economic Considerations 1-27

**Global Tax Issues:** *Outsourcing of Tax Return Preparation* 1-28

Social Considerations 1-29

Equity Considerations 1-29

Political Considerations 1-31

**Tax Fact:** *The Costs of Complexity* 1-32

Influence of the Internal Revenue Service 1-32

Influence of the Courts 1-33

#### SUMMARY 1-33

**Refocus on the Big Picture:** *A Typical Tax Year for a Modern Family* 1-34

### CHAPTER 2

#### WORKING WITH THE TAX LAW 2-1

**The Big Picture:** *Researching Tax Questions* 2-1

#### TAX LAW SOURCES 2-2

Statutory Sources of the Tax Law 2-2

**Tax Fact:** *Scope of the U.S. Tax System* 2-3

**Tax in the News:** *Origin of the April 15 Tax Day* 2-6

Administrative Sources of the Tax Law 2-7

Judicial Sources of the Tax Law 2-10

**Concept Summary:** *Federal Judicial System: Trial Courts* 2-12

**Bridge Discipline:** *Bridge to Public Policy* 2-17

#### WORKING WITH THE TAX LAW—TAX RESEARCH 2-18

Identifying the Problem 2-19

Refining the Problem 2-19

Locating the Appropriate Tax Law Sources 2-19

**Bridge Discipline:** *Bridge to Business Law* 2-20

Assessing Tax Law Sources 2-21

Arriving at the Solution or at Alternative Solutions 2-24

Communicating Tax Research 2-25

Following Up 2-25

Conducting Online Tax Research 2-25

**TAX RESEARCH ON THE CPA EXAMINATION** 2-28  
*Financial Disclosure Insights: Where Does GAAP Come From?* 2-29  
*Bridge Discipline: Bridge to Regulation and Oversight* 2-30  
*Refocus on the Big Picture: Researching Tax Questions* 2-30

**CHAPTER 3**  
**TAXES ON THE FINANCIAL STATEMENTS** 3-1

*The Big Picture: Taxes on the Financial Statements* 3-1

**BOOK-TAX DIFFERENCES** 3-2  
 Different Reporting Entities 3-2  
*Tax in the News: The Watchdog Is Watching* 3-4  
 Different Taxes 3-4  
 Different Methods 3-4  
*Financial Disclosure Insights: Supersized Goodwill* 3-6  
 Tax Return Disclosures 3-6  
*Concept Summary: Income Reporting: Book versus Tax* 3-7  
*Tax Fact: The World of Schedule UTP* 3-8

**INCOME TAXES IN THE FINANCIAL STATEMENTS** 3-8

GAAP Principles 3-8  
*Financial Disclosure Insights: The Book-Tax Income Gap* 3-9  
*Global Tax Issues: Accounting for Income Taxes in International Standards* 3-10  
 Valuation Allowance 3-14  
*Tax Planning Strategies: Releasing Valuation Allowances* 3-16  
 Tax Disclosures in the Financial Statements 3-16  
*Financial Disclosure Insights: Tax Losses and the Deferred Tax Asset* 3-16  
*Financial Disclosure Insights: Valuation Allowances for NOLs* 3-17  
*Tax Fact: Effective Tax Rates for Selected Fortune 100 Companies* 3-18  
*Concept Summary: Steps in Determining the Book Tax Expense* 3-19  
*Tax Fact: Effective Tax Rates Examined* 3-21  
 Special Issues 3-23  
*Tax Planning Strategies: Tax Savings Are Not Always Created Equal* 3-24  
*Concept Summary: Disclosures Under ASC 740-10 (FIN 48)* 3-25  
*Financial Disclosure Insights: Corporate Tax Rate Cuts: Be Careful What You Wish For* 3-26  
*Tax Planning Strategies: Reducing Effective Tax Rates with ASC 740-30 (APB 23) Can Backfire* 3-28  
*Tax in the News: The APB 23 Deferral Summary* 3-29

**BENCHMARKING** 3-30

Dynamic Benchmarking 3-30  
*Bridge Discipline: Bridge to Financial Analysis* 3-31  
 Refining the Analysis 3-31  
 Sustaining the Tax Rate 3-32  
 Uses of Benchmarking Analysis 3-33  
*Concept Summary: Benchmarking Analysis* 3-33  
*Refocus on the Big Picture: Taxes on the Financial Statements* 3-33

**Part 2: Structure of the Federal Income Tax**

**CHAPTER 4**  
**GROSS INCOME** 4-1

*The Big Picture: Just What Is Included in Gross Income?* 4-1

**THE TAX FORMULA** 4-2

Components of the Tax Formula 4-2  
*Global Tax Issues: From "All Sources" Is a Broad Definition* 4-3

**GROSS INCOME—WHAT IS IT?** 4-3

Concepts of Income 4-3  
*Financial Disclosure Insights: What Does "Income" Mean to You?* 4-4  
 Comparing Accounting and Tax Concepts of Income 4-5  
 Form of Receipt 4-6  
*Concept Summary: Gross Income Concepts* 4-6

**YEAR OF INCLUSION** 4-6

Taxable Year 4-6  
*Tax in the News: Academy Awards Participants Have a Tax Problem* 4-7  
 Accounting Methods 4-7  
*Tax Planning Strategies: Cash Receipts Method* 4-8  
*Bridge Discipline: Bridge to Economics and Finance* 4-9  
 Special Rules for Cash Basis Taxpayers 4-10  
*Tax in the News: Congress Rescues Lottery Winners from Constructive Receipt Problems* 4-11  
 Special Rules for Accrual Basis Taxpayers 4-12  
*Tax Planning Strategies: Prepaid Income* 4-13  
*Concept Summary: Income Tax Accounting* 4-13

**INCOME SOURCES** 4-14

Personal Services 4-14  
 Income from Property 4-14  
*Tax Fact: How Much and What Type of Income?* 4-15  
*Global Tax Issues: Which Foreign Dividends Get the Discounted Rate?* 4-16  
*Tax Fact: Business Income and Loss* 4-17  
 Income Received by an Agent 4-17  
*Tax Planning Strategies: Techniques for Reducing Investment Income* 4-17

**SPECIFIC ITEMS OF GROSS INCOME** 4-18

*Financial Disclosure Insights: Loans to Executives Prohibited* 4-19  
 Imputed Interest on Below-Market Loans 4-19  
 Tax Benefit Rule 4-21  
 Interest on Certain State and Local Government Obligations 4-22  
*Bridge Discipline: Bridge to Public Economics* 4-23  
 Improvements on Leased Property 4-23  
*Tax in the News: State Taxation of Other States' Interest* 4-24  
 Life Insurance Proceeds 4-24  
*Tax Planning Strategies: Life Insurance* 4-25  
 Income from Discharge of Indebtedness 4-25  
 Gains and Losses from Property Transactions 4-28



<b>Concept Summary:</b> <i>Income Recognition Rules</i>	4-31	<b>Bridge Discipline:</b> <i>Bridge to Economics and the Business Cycle</i>	5-31
<b>Refocus on the Big Picture:</b> <i>Just What Is Included in Gross Income?</i>	4-31	Business and Personal Use of Automobiles and Other Listed Property	5-31
<b>CHAPTER 5</b>		<b>Concept Summary:</b> <i>Listed Property Cost Recovery</i>	5-34
<b>BUSINESS DEDUCTIONS</b>	<b>5-1</b>	<b>Bridge Discipline:</b> <i>Bridge to Finance and Economics</i>	5-35
<b>The Big Picture:</b> <i>Calculating Deductible Expenses</i>	5-1	Farm Property	5-35
		Alternative Depreciation System (ADS)	5-36
<b>OVERVIEW OF BUSINESS DEDUCTIONS</b>	<b>5-2</b>	<b>AMORTIZATION</b>	<b>5-37</b>
Ordinary and Necessary Requirement	5-2	<b>Tax Planning Strategies:</b> <i>Structuring the Sale of a Business</i>	5-37
Reasonableness Requirement	5-3	<b>DEPLETION</b>	<b>5-37</b>
<b>Tax Planning Strategies:</b> <i>Unreasonable Compensation</i>	5-4	Intangible Drilling and Development Costs (IDCs)	5-38
<b>TIMING OF EXPENSE RECOGNITION</b>	<b>5-4</b>	Depletion Methods	5-38
Cash Method Requirements	5-5	<b>Tax Planning Strategies:</b> <i>Switching Depletion Methods</i>	5-40
<b>Tax Planning Strategies:</b> <i>Time Value of Tax Deductions</i>	5-5	<b>COST RECOVERY TABLES</b>	<b>5-40</b>
Accrual Method Requirements	5-5	<b>Refocus on the Big Picture:</b> <i>Calculating Deductible Expenses</i>	5-44
<b>DISALLOWANCE POSSIBILITIES</b>	<b>5-6</b>	<b>CHAPTER 6</b>	
Public Policy Limitations	5-6	<b>LOSSES AND LOSS LIMITATIONS</b>	<b>6-1</b>
<b>Global Tax Issues:</b> <i>Overseas Gun Sales Result in Large Fines</i>	5-8	<b>The Big Picture:</b> <i>Receiving Tax Benefits from Losses</i>	6-1
Political Contributions and Lobbying Activities	5-8	<b>BAD DEBTS</b>	<b>6-2</b>
Excessive Executive Compensation	5-9	Specific Charge-Off Method	6-2
Disallowance of Deductions for Capital Expenditures	5-9	<b>Tax Fact:</b> <i>Just How Good Is Your Credit?</i>	6-3
<b>Tax in the News:</b> <i>Do Deduction Limits Affect Executive Compensation?</i>	5-10	<b>Concept Summary:</b> <i>The Tax Treatment of Bad Debts Using the Specific Charge-Off Method</i>	6-3
Investigation of a Business	5-10	Business versus Nonbusiness Bad Debts	6-4
Transactions between Related Parties	5-12	Loans between Related Parties	6-4
Lack of Adequate Substantiation	5-13	<b>WORTHLESS SECURITIES</b>	<b>6-5</b>
Expenses and Interest Related to Tax-Exempt Income	5-13	Small Business Stock (§ 1244)	6-5
<b>CHARITABLE CONTRIBUTIONS</b>	<b>5-14</b>	<b>Tax Planning Strategies:</b> <i>Maximizing the Benefits of § 1244</i>	6-6
Property Contributions	5-15	<b>CASUALTY AND THEFT LOSSES</b>	<b>6-6</b>
Limitations Imposed on Charitable Contribution Deductions	5-16	Definition of Casualty	6-6
<b>RESEARCH AND EXPERIMENTAL EXPENDITURES</b>	<b>5-17</b>	Deduction of Casualty Losses	6-7
Expense Method	5-17	<b>Tax Planning Strategies:</b> <i>Documentation of Related-Taxpayer Loans, Casualty Losses, and Theft Losses</i>	6-8
Deferral and Amortization Method	5-18	Definition of Theft	6-8
<b>OTHER EXPENSE RULES</b>	<b>5-18</b>	<b>Tax in the News:</b> <i>The Tax Consequences of Lost Bitcoins</i>	6-9
Interest Expense	5-18	Loss Measurement	6-9
Taxes	5-19	Casualty and Theft Losses of Individuals	6-10
Domestic Production Activities Deduction	5-19	<b>Concept Summary:</b> <i>Casualty Gains and Losses</i>	6-11
<b>Tax Fact:</b> <i>Cost Recovery by Any Other Name</i>	5-22	<b>NET OPERATING LOSSES</b>	<b>6-11</b>
<b>COST RECOVERY ALLOWANCES</b>	<b>5-22</b>	Introduction	6-11
Overview	5-22	Carryback and Carryover Periods	6-12
Depreciation and Cost Recovery	5-22	<b>THE TAX SHELTER PROBLEM</b>	<b>6-13</b>
<b>Bridge Discipline:</b> <i>Bridge to Finance</i>	5-23	<b>Bridge Discipline:</b> <i>Bridge to Finance</i>	6-14
Modified Accelerated Cost Recovery System (MACRS)	5-24	<b>AT-RISK LIMITATIONS</b>	<b>6-14</b>
<b>Concept Summary:</b> <i>Statutory Percentage Method under MACRS</i>	5-25	<b>Concept Summary:</b> <i>Calculation of At-Risk Amount</i>	6-16
Cost Recovery for Personal Property	5-25	<b>PASSIVE LOSS LIMITS</b>	<b>6-16</b>
Cost Recovery for Real Estate	5-27	Classification and Impact of Passive Income and Loss	6-16
Straight-Line Election	5-28	<b>Tax in the News:</b> <i>"Passive" under the Tax Law May Not Be "Passive" in the Real World</i>	6-17
Additional First-Year Depreciation	5-28		
<b>Financial Disclosure Insights:</b> <i>Tax and Book Depreciation</i>	5-29		
Election to Expense Assets (§ 179)	5-29		
<b>Tax in the News:</b> <i>Cost Segregation</i>	5-30		

**Tax in the News: If You Can't Trust Your Tax Preparer, Who Can You Trust?** 6-20

Taxpayers Subject to the Passive Loss Rules 6-20

Rules for Determining Passive Activities 6-21

Material Participation 6-22

**Concept Summary: Tests to Determine Material Participation** 6-23

**Tax in the News: The Passive Loss Rules Are a Trap for the Novice Landlord** 6-24

Rental Activities 6-24

**Concept Summary: Passive Activity Loss Rules: Key Issues and Answers** 6-25

Interaction of At-Risk and Passive Loss Limits 6-26

**Concept Summary: Treatment of Losses Subject to the At-Risk and Passive Activity Loss Limitations** 6-27

Special Rules for Real Estate 6-27

**Tax in the News: Full-Time Employees May Face Difficulty Showing Real Estate Professional Status** 6-28

Disposition of Passive Activities 6-30

**Tax Planning Strategies: Utilizing Passive Losses** 6-31

**Refocus on the Big Picture: Receiving Tax Benefits from Losses** 6-32

Like-Kind Property 7-20

Exchange Requirement 7-21

Boot 7-21

Basis and Holding Period of Property Received 7-22

**Bridge Discipline: Bridge to Economics** 7-24

**INVOLUNTARY CONVERSIONS—§ 1033 7-24**

Involuntary Conversion Defined 7-25

Replacement Property 7-25

**Concept Summary: Involuntary Conversions: Replacement Property Tests** 7-26

Time Limitation on Replacement 7-26

Nonrecognition of Gain 7-27

**Tax Planning Strategies: Recognizing Involuntary Conversion Gains** 7-28

**OTHER NONRECOGNITION PROVISIONS 7-29**

Transfer of Assets to Business Entity—§§ 351 and 721 7-29

Exchange of Stock for Property—§ 1032 7-29

Certain Exchanges of Insurance Policies—§ 1035 7-29

Exchange of Stock for Stock of the Same Corporation—§ 1036 7-29

Rollovers into Specialized Small Business Investment Companies—§ 1044 7-29

Sale of a Principal Residence—§ 121 7-30

Transfers of Property between Spouses or Incident to Divorce—§ 1041 7-30

**Refocus on the Big Picture: Calculating Basis and Recognized Gain for Property Transactions** 7-30

## Part 3: Property Transactions

### CHAPTER 7 PROPERTY TRANSACTIONS: BASIS, GAIN AND LOSS, AND NONTAXABLE EXCHANGES 7-1

**The Big Picture: Calculating Basis and Recognized Gain for Property Transactions** 7-1

**DETERMINATION OF GAIN OR LOSS 7-2**

Realized Gain or Loss 7-2

**Bridge Discipline: Bridge to Financial Accounting** 7-5

**Tax in the News: Tax Implications of Virtual Currency (Bitcoin)** 7-6

Recognized Gain or Loss 7-6

**Concept Summary: Recognized Gain or Loss** 7-7

Nonrecognition of Gain or Loss 7-7

**BASIS CONSIDERATIONS 7-8**

Determination of Cost Basis 7-8

**Tax in the News: Brokers Provide Cost Basis Data to Taxpayers (and the IRS)** 7-10

Gift Basis 7-10

**Tax Planning Strategies: Gift Planning** 7-12

Property Acquired from a Decedent 7-13

**Tax Planning Strategies: Property from a Decedent** 7-14

Disallowed Losses 7-14

**Tax Planning Strategies: Avoiding Wash Sales** 7-15

**Tax in the News: Triple the Misery!** 7-16

Conversion of Property from Personal Use to Business or Income-Producing Use 7-16

Summary of Basis Adjustments 7-16

**Concept Summary: Adjustments to Basis** 7-17

**GENERAL CONCEPT OF A NONTAXABLE EXCHANGE 7-18**

**LIKE-KIND EXCHANGES—§ 1031 7-19**

**Tax Planning Strategies: Like-Kind Exchanges** 7-19

### CHAPTER 8 PROPERTY TRANSACTIONS: CAPITAL GAINS AND LOSSES, SECTION 1231, AND RECAPTURE PROVISIONS 8-1

**The Big Picture: Capital Gains and Losses, § 1231 Gains and Losses, and Recapture** 8-1

**GENERAL SCHEME OF TAXATION 8-2**

**CAPITAL ASSETS 8-2**

Definition of a Capital Asset (§ 1221) 8-3

Statutory Expansions 8-5

**SALE OR EXCHANGE 8-6**

Worthless Securities and § 1244 Stock 8-6

**Tax in the News: Bankruptcy and Worthless Stock** 8-7

Retirement of Corporate Obligations 8-7

Options 8-7

**Concept Summary: Options: Consequences to the Grantor and Grantee** 8-9

Patents 8-9

Franchises, Trademarks, and Trade Names (§ 1253) 8-10

**Concept Summary: Franchises: Consequences to the Franchisor and Franchisee** 8-12

Lease Cancellation Payments 8-12

**HOLDING PERIOD 8-13**

Special Holding Period Rules 8-13

Short Sales 8-14

**Tax Planning Strategies: Timing Capital Gains** 8-15

<b>TAX TREATMENT OF CAPITAL GAINS AND LOSSES OF NONCORPORATE TAXPAYERS</b>	<b>8-16</b>	<b>THE INDIVIDUAL TAX FORMULA</b>	<b>9-2</b>
Capital Gains	8-16	<b>Concept Summary:</b> <i>Individual Income Tax Formula</i>	9-2
<b>Tax Planning Strategies:</b> <i>Gifts of Appreciated Securities</i>	8-16	Components of the Tax Formula	9-2
<b>Global Tax Issues:</b> <i>Capital Gain Treatment in the United States and Other Countries</i>	8-17	<b>STANDARD DEDUCTION</b>	<b>9-6</b>
<b>Concept Summary:</b> <i>Capital Gains of Noncorporate Taxpayers</i>	8-18	Basic and Additional Standard Deduction	9-6
Capital Losses	8-18	Special Limitations on the Standard Deduction for Dependents	9-8
Capital Gain and Loss Netting Process	8-18	<b>PERSONAL EXEMPTIONS</b>	<b>9-8</b>
<b>Tax Planning Strategies:</b> <i>Matching Gains with Losses</i>	8-20	<b>DEPENDENCY EXEMPTIONS</b>	<b>9-9</b>
Small Business Stock	8-21	Qualifying Child	9-9
<b>TAX TREATMENT OF CAPITAL GAINS AND LOSSES OF CORPORATE TAXPAYERS</b>	<b>8-22</b>	<b>Concept Summary:</b> <i>Tiebreaker Rules for Claiming Qualifying Child</i>	9-10
<b>Tax Fact:</b> <i>Capital Gains for the Wealthy?</i>	8-23	Qualifying Relative	9-11
<b>SECTION 1231 ASSETS</b>	<b>8-23</b>	<b>Tax Planning Strategies:</b> <i>Multiple Support Agreements and the Medical Expense Deduction</i>	9-14
Relationship to Capital Assets	8-23	Other Rules for Dependency Exemptions	9-14
Property Included	8-24	<b>Tax Planning Strategies:</b> <i>Problems with a Joint Return</i>	9-15
Property Excluded	8-24	Comparison of Categories for Dependency Exemptions	9-15
<b>Tax in the News:</b> <i>Loss from Cattle Rustling</i>	8-25	<b>Concept Summary:</b> <i>Tests for Dependency Exemption</i>	9-15
Casualty or Theft and Nonpersonal-Use Capital Assets	8-25	Phaseout of Exemptions	9-16
General Procedure for § 1231 Computation	8-25	<b>TAX DETERMINATION—FILING CONSIDERATIONS</b>	<b>9-16</b>
<b>Concept Summary:</b> <i>Section 1231 Netting Procedure (Discussed in Section 8-7e)</i>	8-26	<b>Tax in the News:</b> <i>How to Subtly Pluck the Chicken</i>	9-17
<b>SECTION 1245 RECAPTURE</b>	<b>8-29</b>	Filing Requirements	9-17
<b>Bridge Discipline:</b> <i>Bridge to Financial Accounting</i>	8-30	Filing Status	9-18
Section 1245 Property	8-30	<b>Bridge Discipline:</b> <i>Bridge to Equity or Fairness</i>	9-19
Observations on § 1245	8-31	<b>Global Tax Issues:</b> <i>Filing a Joint Return</i>	9-20
<b>Tax Planning Strategies:</b> <i>Depreciation Recapture and § 179</i>	8-31	<b>TAX DETERMINATION—COMPUTATION PROCEDURES</b>	<b>9-21</b>
<b>SECTION 1250 RECAPTURE</b>	<b>8-31</b>	Tax Table Method	9-21
<b>Tax in the News:</b> <i>Building or Tangible Personal Property?</i>	8-32	Tax Rate Schedule Method	9-21
<b>Concept Summary:</b> <i>Comparison of § 1245 and § 1250 Depreciation Recapture</i>	8-32	<b>Tax Planning Strategies:</b> <i>Shifting Income and Deductions across Time</i>	9-22
Unrecaptured § 1250 Gain (Real Estate 25% Gain)	8-32	Computation of Net Taxes Payable or Refund Due	9-22
Additional Recapture for Corporations	8-33	<b>Tax in the News:</b> <i>Same-Sex Couples May Face a Tax Filing Nightmare</i>	9-23
<b>Tax Planning Strategies:</b> <i>Selling Depreciable Real Estate</i>	8-34	Additional Taxes for Certain Individuals	9-24
<b>EXCEPTIONS TO §§ 1245 AND 1250</b>	<b>8-34</b>	Kiddie Tax—Unearned Income of Children Taxed at Parents' Rate	9-25
Gifts	8-34	<b>Tax Planning Strategies:</b> <i>Income of Certain Children</i>	9-26
Death	8-35	<b>TAX RETURN FILING PROCEDURES</b>	<b>9-26</b>
Charitable Transfers	8-35	Selecting the Proper Form	9-26
Certain Nontaxable Transactions	8-35	<b>Tax Fact:</b> <i>What Form of Tax Compliance Is Right for You?</i>	9-26
Like-Kind Exchanges and Involuntary Conversions	8-35	The E-File Approach	9-27
<b>REPORTING PROCEDURES</b>	<b>8-36</b>	When and Where to File	9-27
<b>Tax Planning Strategies:</b> <i>Timing of Recapture</i>	8-36	Modes of Payment	9-27
<b>Refocus on the Big Picture:</b> <i>Capital Gains and Losses, § 1231 Gains and Losses, and Recapture</i>	8-37	<b>Refocus on the Big Picture:</b> <i>A Divided Household</i>	9-27

## Part 4: Taxation of Individuals

<b>CHAPTER 9</b>	
<b>INDIVIDUALS AS THE TAXPAYER</b>	<b>9-1</b>
<b>The Big Picture:</b> <i>A Divided Household</i>	9-1

<b>CHAPTER 10</b>	
<b>INDIVIDUALS: INCOME, DEDUCTIONS, AND CREDITS</b>	<b>10-1</b>
<b>The Big Picture:</b> <i>The Tax Implications of Life!</i>	10-1

<b>OVERVIEW OF INCOME PROVISIONS APPLICABLE TO INDIVIDUALS</b>	<b>10-2</b>
--	-------------

**SPECIFIC INCLUSIONS APPLICABLE TO INDIVIDUALS 10-2**

**Bridge Discipline:** *Bridge to Economics and Finance* 10-3  
 Alimony and Separate Maintenance Payments 10-3  
**Tax in the News:** *Social Security Benefits as a Source of Federal Revenue* 10-5  
 Prizes and Awards 10-5  
 Unemployment Compensation 10-5  
 Social Security Benefits 10-5

**SPECIFIC EXCLUSIONS APPLICABLE TO INDIVIDUALS 10-6**

Gifts and Inheritances 10-6  
**Tax in the News:** *Begging as a Tax-Disfavored Occupation* 10-7  
 Scholarships 10-7  
 Damages 10-8  
**Concept Summary:** *Taxation of Damages* 10-9  
 Workers' Compensation 10-10  
 Accident and Health Insurance Benefits 10-10  
 Educational Savings Bonds 10-10

**ITEMIZED DEDUCTIONS 10-11**

Medical Expenses 10-12  
**Tax in the News:** *Medical Expense Deductions Are Now Harder to Come By* 10-14  
 Taxes 10-15  
**Tax Planning Strategies:** *Timing the Payment of Deductible Taxes* 10-17  
 Interest 10-17  
**Concept Summary:** *Deductibility of Personal, Education, Investment, and Mortgage Interest* 10-21  
 Charitable Contributions 10-21  
**Global Tax Issues:** *Choose the Charity Wisely* 10-23  
**Concept Summary:** *Determining the Deduction for Contributions of Property by Individuals* 10-24  
 Miscellaneous Itemized Deductions Subject to 2 Percent Floor 10-25  
 Other Miscellaneous Deductions 10-26  
 Overall Limitation on Certain Itemized Deductions 10-26  
**Tax Planning Strategies:** *Effective Utilization of Itemized Deductions* 10-27

**INDIVIDUAL TAX CREDITS 10-28**

Adoption Expenses Credit 10-28  
 Child Tax Credit 10-28  
 Credit for Child and Dependent Care Expenses 10-29  
 Education Tax Credits 10-31  
 Earned Income Credit 10-32

**AFFORDABLE CARE ACT PROVISIONS 10-33**

Individual Shared Responsibility Payment 10-33  
 Premium Tax Credit 10-34  
**Refocus on the Big Picture:** *The Tax Implications of Life!* 10-35

**CHAPTER 11  
 INDIVIDUALS AS EMPLOYEES AND PROPRIETORS 11-1**

**The Big Picture:** *Self-Employed versus Employee—What's the Difference?* 11-1

**EMPLOYEE VERSUS SELF-EMPLOYED 11-2**

Factors Considered in Classification 11-2

**Bridge Discipline:** *Bridge to Equity or Fairness and Business Law* 11-3  
**Tax Planning Strategies:** *Self-Employed Individuals* 11-4

**EXCLUSIONS AVAILABLE TO EMPLOYEES 11-4**

**Tax in the News:** *Same-Sex Marriage and Employer-Provided Insurance* 11-5  
 Employer-Sponsored Accident and Health Plans 11-5  
**Bridge Discipline:** *Bridge to Economic and Societal Needs* 11-6  
 Medical Reimbursement Plans 11-6  
 Long-Term Care Benefits 11-7  
 Meals and Lodging Furnished for the Convenience of the Employer 11-7  
 Group Term Life Insurance 11-9  
 Qualified Tuition Reduction Plans 11-9  
 Other Employee Fringe Benefits 11-10  
**Tax in the News:** *Providing a Feel-Good Fringe Benefit at a Low Cost* 11-11  
 Cafeteria Plans 11-11  
 Flexible Spending Plans 11-12  
**Concept Summary:** *Employee Fringe Benefits* 11-12  
 General Classes of Excluded Benefits 11-13  
**Concept Summary:** *General Classes of Fringe Benefits* 11-17  
 Foreign Earned Income 11-17

**EMPLOYEE EXPENSES 11-18**

Transportation Expenses 11-18  
 Travel Expenses 11-20  
**Tax Planning Strategies:** *Transportation and Travel Expenses* 11-22  
 Moving Expenses 11-22  
**Concept Summary:** *Meeting and Not Meeting the Distance Test* 11-23  
**Global Tax Issues:** *Expatriates and the Moving Expense Deduction* 11-24  
**Tax Planning Strategies:** *Moving Expenses* 11-25  
 Education Expenses 11-25  
**Tax in the News:** *Is an MBA Degree Deductible?* 11-26  
**Tax Planning Strategies:** *Education Expenses* 11-26  
 A Limited Deduction Approach 11-27  
 Entertainment Expenses 11-29  
**Tax Planning Strategies:** *Entertainment Expenses* 11-30  
 Other Employee Expenses 11-31  
 Classification of Employee Expenses 11-33  
**Tax Planning Strategies:** *Unreimbursed Employee Business Expenses* 11-34  
 Contributions to Individual Retirement Accounts 11-35  
**Concept Summary:** *Traditional IRAs and Roth IRAs Compared* 11-38

**INDIVIDUALS AS PROPRIETORS 11-38**

The Proprietorship as a Business Entity 11-38  
 Income of a Proprietorship 11-38  
 Deductions Related to a Proprietorship 11-39  
**Tax in the News:** *The Tax Gap Includes \$58 Billion in Payroll Taxes* 11-39  
 Retirement Plans for Self-Employed Individuals 11-41  
**Tax Planning Strategies:** *Important Dates Related to IRAs and Keogh Plans* 11-42  
**Tax Planning Strategies:** *Factors Affecting Retirement Plan Choices* 11-43  
 Accounting Periods and Methods 11-44  
 Estimated Tax Payments 11-44