

# **Solutions Manual**

## **South-Western Federal Taxation: Comprehensive Volume**

**2014 Edition**

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Proposed solutions to the **Research Problems** are found in the Instructor's Guide and the **Appendix E Tax Return Problems** are found at the Instructor Companion Site for the textbook ([www.cengage.com/taxation/swft](http://www.cengage.com/taxation/swft)). Previously, the tax returns were a part of the Instructor's Guide for the text, but now they are available online at this site as free-standing documents as well as on the Instructor's Resource CD.

**CHAPTER 1**  
**AN INTRODUCTION TO TAXATION**  
**AND UNDERSTANDING THE FEDERAL TAX LAW**  
**SOLUTIONS TO PROBLEM MATERIALS**

<u>Question/ Problem</u>	<u>Learning Objective</u>	<u>Topic</u>	<u>Status: Present Edition</u>	<u>Q/P in Prior Edition</u>
1	LO 1	Tax effect on a change in circumstances	Unchanged	1
2	LO 1	Interplay of different types of taxes	Unchanged	2
3	LO 2	Constitutionality of Federal income tax	Unchanged	3
4	LO 2	Income tax as a “mass tax”	Unchanged	4
5	LO 2	Pay-as-you-go system	Unchanged	5
6	LO 3	Adam Smith and canon of economy	New	
7	LO 3	Proportional and progressive rates contrasted	Unchanged	7
8	LO 4	Ad valorem tax on realty: conversion from tax-exempt to residential status	Unchanged	8
9	LO 4	Conversion of tax-exempt realty to commercial status and effect on ad valorem property tax	Unchanged	9
10	LO 4	Ad valorem taxes: tax holiday as an inducement for new business	New	
11	LO 4	Ad valorem tax on residential property: reasons for variation	New	
12	LO 4	Ad valorem tax on personalty: means of avoidance	New	
13	LO 4	Federal excise status: current status as to scope	New	
14	LO 4	Excise taxes: hotel occupancy and car rental	Unchanged	14
15	LO 4	Excise and general sales taxes compared	Unchanged	15
16	LO 4	Avoiding state or local sales tax through use of out-of-area purchases	New	
17	LO 4	Avoiding sales tax through Internet purchase	Unchanged	18
18	LO 4	Estate and inheritance taxes contrasted	Unchanged	19
19	LO 4	Federal gift tax: availability of the marital deduction for transfers between spouses	Unchanged	20
20	LO 4	Federal transfer taxes: justification for and application of unified credit	Unchanged	21
21	LO 4	Federal gift tax: annual exclusion	New	

<u>Question/ Problem</u>	<u>Learning Objective</u>	<u>Topic</u>	<u>Status: Present Edition</u>	<u>Q/P in Prior Edition</u>
22	LO 4	Federal taxes: individual and corporations compared	New	
23	LO 4	State income tax: various attributes	Unchanged	24
24	LO 4	State income tax: audit potential due to IRS assessment	Unchanged	25
25	LO 4	Application of jock tax	Unchanged	26
26	LO 4, 5	State income tax return disclosure of Internet purchases; client refusal to answer tax return question and ethical implications	Unchanged	27
27	LO 4	State income taxes: checkoff boxes and special causes	Unchanged	28
28	LO 4	State taxes: amnesty programs	Unchanged	29
29	LO 4	FICA and FUTA contrasted	Unchanged	30
30	LO 4	FICA: Medicare component	New	
31	LO 4	FICA: application to family	Unchanged	31
32	LO 4	Severance, franchise, and occupation taxes and fees	Unchanged	32
33	LO 4	VAT: characteristics and usage	Unchanged	33
34	LO 4	National sales tax and VAT: regressive aspects	Unchanged	34
35	LO 4, 5	Tax problems of cash basis taxpayers with high employment turnover	Unchanged	35
36	LO 5	Assessing risk of audit by the IRS	Unchanged	36
37	LO 5	IRS audit: characteristics of	Modified	37
38	LO 5	IRS audit: appeal procedures	Unchanged	38
39	LO 5	Statute of limitations: purpose and application of	Unchanged	39
40	LO 5	Statute of limitations: IRS assessments	Unchanged	40
41	LO 5	Interest on tax refunds	Unchanged	41
42	LO 5, 6	Statute of limitations and substantial omissions; ethical considerations of tax return preparer	Unchanged	42
43	LO 5	Penalties for failure to file and failure to pay	New New	
44	LO 5	Penalties for negligence and fraud	Unchanged	
45	LO 5, 6	Tax practice and ethical guidelines: statute of limitations		45
46	LO 5, 6	Ethics: offshore preparation of tax returns	Unchanged	46
47	LO 7	Revenue neutral tax reform	Modified	47
48	LO 7	Multiple justification for several tax provisions	Unchanged	48
49	LO 7	Justification for various tax provisions	Modified	49
50	LO 7, 8	Justification for various tax provisions	Modified	51
51	LO 7	Wherewithal to pay concept illustrated: involuntary conversion	New	
52	LO 8	Arm's length concept: definition of and reason for	Unchanged	52
53	LO 8	Tax treatment of leasehold improvements: judicial versus legislative rules	Unchanged	53



**DISCUSSION QUESTIONS**

1.
  - a. By becoming a dealer, any gains and losses John has are converted from capital to ordinary classification.
  - b. Theresa has become self-employed. Now she will be subject to self-employment tax and will have to make quarterly installment payments of estimated income and payroll taxes.
  - c. Due to the home mortgage interest deduction and property tax deduction, most new homeowners will itemize their deductions *from* AGI. Thus, Paul probably will no longer claim the standard deduction on his income tax return.

p. 1-2

2. The income tax consequences that result are Marvin's principal concern. Any rent he receives is taxed as income, but operating expenses and depreciation will generate deductions that will offset some or all of the income or even yield a loss. Marvin must also consider the effect of other taxes. Because the property is being converted from residential to commercial use, he can expect an increase in the ad valorem property taxes levied by local (and perhaps even the state) taxing authorities. Besides the real estate taxes, personal property taxes could be imposed on the furnishings. p. 1-2
3. The statement is only partly correct. The Federal income tax on corporations was not a problem as it had previously been sanctioned by the Supreme Court. What had been declared unconstitutional was the tax on individuals as it applied to the income *from property*. p. 1-3
4. In order to finance our participation in World War II, the scope of the income tax was expanded considerably—from a limited coverage of 6% to over 74% of the population. Hence, the description of the income tax as being a “mass tax” became appropriate. p. 1-4
5. For wage earners, the tax law requires employers to withhold a specified dollar amount from wages paid to the employee to cover income taxes and payroll taxes. Persons with non-wage income generally are required to make quarterly payments to the IRS for estimated taxes. Both procedures ensure that taxpayers will be financially able to meet their annual tax liabilities. That is, the amounts withheld are meant to prepay the employee's income taxes and payroll taxes related to the wages earned. pp. 1-4 and 1-5
6. As to Adam Smith's canon on *economy*, the Federal income tax yields a mixed result. From the standpoint of the IRS, *economy* is there as collection costs are nominal (when compared to revenue generated). *Economy* is not present, however, if one looks to the compliance effort and costs expended by taxpayers. p. 1-5
7. A tax is *proportional* if the rate of tax remains constant for any given income level. The tax is *progressive* if a higher rate of tax applies as the tax base increases. pp. 1-5 and 1-6
8.
  - a. The parsonage probably was not listed on the property tax rolls since it was owned by a tax-exempt church. Apparently, the taxing authorities are not aware that ownership has changed.
  - b. Ethan should notify the authorities of his purchase. This will force him to pay back taxes but will eliminate *future* interest and penalties.

p. 1-7

9. Although the Baker Motors bid is the lowest, from a long-term financial standpoint, it is the best. The proposed use of the property by the state and the church probably will make it exempt from the School District's ad valorem tax. This would hardly be the case with a car dealership. In fact, commercial properties (e.g., car dealerships) often are subject to higher tax rates. p. 1-7
10. a. In this case, the "tax holiday" probably concerns exemption from ad valorem taxes. "Generous" could involve an extended period of time (e.g., 10 years) and include both realty and personalty.
- b. The school district could be affected in two ways. First, due to the erosion of the tax base, less revenue will be forthcoming. Second, new workers mean new families and more children to educate.
- p. 1-7
11. A possible explanation could be that Sophia made capital improvements (e.g., added a swimming pool) to her residence while her parents became retirees (e.g., reached age 65). p. 1-7
12. Presuming that the dockage facilities are comparable in Massachusetts, the Morgans may be trying to avoid ad valorem taxes. Taxes on nonbusiness personalty vary from one state to another and are frequently avoided. p. 1-8
13. Until recently, it appeared that Federal excise taxes had declined significantly as to the number of transactions covered. Taxes on the sale of jewelry, leather goods, cosmetics, and admission to entertainment events are no longer taxed by the Federal government. But the enactment of the gas-guzzler tax and the tax on tanning salons, plus the increase in the tax on tobacco products, seems to indicate an expansion of excise taxes at the Federal level. p. 1-9
14. Herman could have been overcharged, but at least part of the excess probably is attributable to a hotel occupancy tax and a car rental tax. In the major cities, these types of excise taxes have become a popular way of financing capital improvements, such as sports arenas and stadiums. Consequently, the amount of the taxes could be significant. p. 1-10
15. An *excise tax* is limited to a particular transaction (e.g., sale of gasoline), while a general *sales tax* covers a multitude of transactions (e.g., sale of all non-food goods).
- a. The following states *do not* impose a general sales tax: Alaska, Delaware, Montana, New Hampshire, and Oregon.
- b. There is no Federal general sales tax.
- p. 1-10
16. a. Jackson County must be in a state that imposes a lower (or *no*) sales tax. With certain major purchases (i.e., "big ticket" items), any use tax imposed by the state of their residence could come into play.
- b. In some states, the sales tax rate can vary depending on the county and/or city.
- p. 1-10 and Examples 5 and 6
17. Earl probably purchased his computer out of state by use of a catalog or through the Internet. In such cases, state collection of the sales (use) tax is not unlikely. p. 1-11