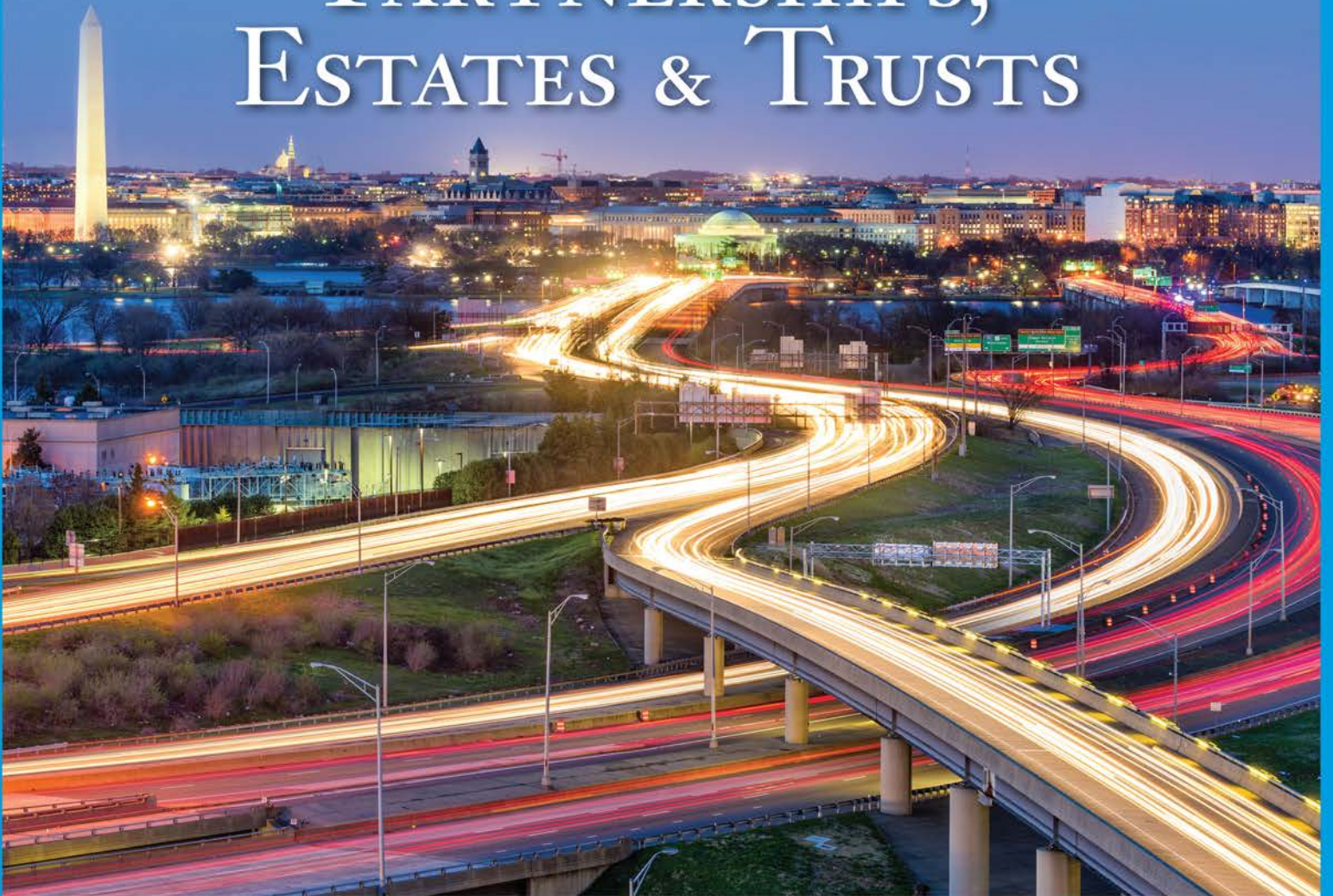




SOUTH-WESTERN
FEDERAL TAXATION

CORPORATIONS, PARTNERSHIPS, ESTATES & TRUSTS



INCLUDED:

THOMSON REUTERS
CHECKPOINT

 **intuit
proconnect**

 **BECKER**
PROFESSIONAL EDUCATION

Raabe • Young
Hoffman • Nellen
Maloney

2020

Income Tax Rates—Estates and Trusts

Tax Year 2019

Taxable Income		The Tax Is:	
Over—	But not Over—		Of the Amount Over—
\$ 0	\$ 2,600	10%	\$ 0
2,600	9,300	\$ 260.00 + 24%	2,600
9,300	12,750	1868.00 + 35%	9,300
12,750	3,075.50 + 37%	12,750

Income Tax Rates—C Corporations, 2018 and after

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

Tax Formula for Corporate Taxpayers

Income (from whatever source).....	\$ xxx,xxx
Less: Exclusions from gross income.....	— xx,xxx
Gross Income	\$ xxx,xxx
Less: Deductions.....	— xx,xxx
Taxable Income	\$ xxx,xxx
Applicable tax rates.....	× xx%
Gross Tax	\$ xx,xxx
Less: Tax credits and prepayments.....	— x,xxx
Tax Due (or refund).....	<u>\$ xx,xxx</u>

Unified Transfer Tax Rates

For Gifts Made and for Deaths after 2012






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



Powerful preparation. Maximum confidence.

The right tools to help prepare you for the Exam

With Becker Professional Education, you get a fully integrated CPA Exam Review course that helps you:

	<p>MOVE BEYOND MEMORIZATION TO APPLICATION</p> <p>Interactive simulations and videos move you beyond memorization, helping you apply concepts – a critical component of the CPA Exam.</p>	<p>CPA SkillMaster Videos</p> <p>Tackle Task-Based Simulations with confidence. Our expert instructors take you through the most complex questions step-by-step.</p> <p><i>It's like having your own CPA coach!</i></p>
	<p>STUDY SMART</p> <p>Adapt2U pre-assessment provides you a recommended study path.</p>	
	<p>TRACK PROGRESS AND BUILD CONFIDENCE</p> <p>Mock exams, progress tests and a study planner help you focus on where you need the most help.</p>	
	<p>LEARN WHAT'S NEEDED</p> <p>Study with a course that replicates the CPA Exam.</p>	
	<p>CHOOSE FROM 3 FLEXIBLE COURSE FORMATS</p> <p>Choose from Self-Study, LiveOnline or Live Classroom formats.</p>	

ProConnect™ Tax Online

Work like a pro.

Get the #1 cloud-based professional tax software for free.^{1, 2}

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

- **Work with confidence.**

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

- **Work smarter.**

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

- **Work from anywhere.**

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

Visit TaxEducation.Intuit.com to get started.

Only one sign-up per student. No special code required. If you have trouble accessing or using the software, reach out to us at taxeducation_support@intuit.com anytime for help.

¹ Based on Intuit internal data of the number of paid users of ProConnect Tax Online for Tax Year 2016 compared to publicly available statements from competitors for the same time period.

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

SOUTH-WESTERN FEDERAL TAXATION

CORPORATIONS, PARTNERSHIPS, ESTATES & TRUSTS

2020

General Editors

William A. Raabe
Ph.D., CPA

James C. Young
Ph.D., CPA

William H. Hoffman, Jr.
J.D., Ph.D., CPA

Annette Nellen
J.D., CPA, CGMA

David M. Maloney
Ph.D., CPA

Contributing Authors

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

Gregory Carnes
Ph.D., CPA
University of North Alabama

D. Larry Crumbley
Ph.D., CPA
Louisiana State University

Andrew Cuccia
Ph.D., CPA
University of Oklahoma

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

Steven L. Gill
Ph.D., CPA
San Diego State University

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

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

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

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

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

Debra L. Sanders
Ph.D., CPA
Washington State
University, Vancouver

Toby Stock
Ph.D., CPA
Ohio University

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

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



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

Copyright 2020 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. WCN 02-200-203

Copyright 2020 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

This is an electronic version of the print textbook. Due to electronic rights restrictions, some third party content may be suppressed. Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. The publisher reserves the right to remove content from this title at any time if subsequent rights restrictions require it. For valuable information on pricing, previous editions, changes to current editions, and alternate formats, please visit www.cengage.com/highered 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:
Corporations, Partnerships, Estates
& Trusts, 2020 Edition**

**William A. Raabe, James C. Young,
William H. Hoffman, Jr., Annette Nellen,
David M. Maloney**

Senior Vice President, Higher Ed Product, Content,
and Market Development: Erin Joyner

Product Director: Jason Fremder

Assoc. Product Manager: Jonathan Gross

Sr. Content Manager: Nadia Saloom

Learning Designer: Natasha Allen

Marketing Manager: Chris Walz

Sr. Digital Delivery Lead: Tim Richison

Production Service: SPi Global

Designer: Chris A. Doughman

Text Designer: Red Hangar Design

Cover Designer: Bethany Bourgeois

Cover Image: iStock.com/Sean Pavone

Intellectual Property:

Analyst: Reba Frederics

Project Manager: Carly Belcher

Design Images:

Concept Summary:

iStock.com/enot-poloskun

Global Tax Issues: enot-poloskun/

E+/Getty Images

Ethics & Equity: iStock.com/LdF

Comprehensive Tax Return Problems:

iStock.com/peepo

Financial Disclosure Insights: Vyaseleva

Elena/Shutterstock.com

© 2020, 2019 Cengage Learning, Inc.

Unless otherwise noted, all content is © Cengage.

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

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

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

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

Tax software: Source: Intuit Proconnect

Becker CPA Review: Source: Becker CPA

Excel screenshots ©Microsoft Corporation.

ISSN: 0270-5265

2020 Annual Edition

Student Edition ISBN: 978-0-357-10920-5

Student Edition with Intuit Proconnect + RIA Checkpoint

ISBN: 978-0-357-10916-8

Cengage

20 Channel Center Street

Boston, MA 02210

USA

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

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

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



Preface

COMMITTED TO EDUCATIONAL SUCCESS

South-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.

Corporations, Partnerships, Estates & Trusts, 2020 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.

Corporations, Partnerships, Estates & Trusts, 2020 Edition 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 taxation.

In revising the 2020 Edition, we focused on:

- **Accessibility. Clarity. Substance.** The text authors and editors made this their mantra as they revised the 2020 edition. Coverage has been streamlined to make it more accessible to students, and difficult concepts have been clarified, all without losing the substance that makes up the *South-Western Federal Taxation series*.
- **Developing professional skills.** SWFT excels in bringing students to a professional level in their tax knowledge and skills, to prepare them for immediate success in their careers. In this regard, we include development of speaking and writing communications skills, the use of tax preparation and tax research software, orientation toward success on the CPA Exam, consideration of the time value of money in the tax planning process, and facility with advanced spreadsheet applications and data analytics.
- **CengageNOWv2 as a complete learning system.** Cengage Learning understands that digital learning solutions are central to the classroom. Through sustained research, we continually refine our learning solutions in CengageNOWv2 to meet evolving student and instructor needs. CengageNOWv2 fulfills learning and course management needs by offering a personalized study plan, video lectures, auto-graded homework, auto-graded tests, and a full eBook with features and advantages that address common challenges.

Learning Tools and Features to Help Students Make the Connection

FULL-COLOR DESIGN: We understand that students struggle with learning difficult tax code concepts and applying them to real-world scenarios. The 2020 edition uses color to bring the text to life, capture student attention, and present the tax code in an understandable and logical format.

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

CHAPTER 4 Corporations: Organization and Capital Structure

LEARNING OBJECTIVES: After completing Chapter 4, you should be able to:

- 1 Explain the tax consequences of incorporating a business.
- 2 Describe the special rules that apply when a corporation acquires shareholder liabilities.
- 3 Identify the basis issues relevant to the shareholder and the corporation.
- 4 Explain the tax aspects of the capital structure of a corporation.

CHAPTER OUTLINE

4.1 Organization of and Transfers to Controlled Corporations, 4-2

- 4.1-1 Section 351 Historical and General Rules, 4-2
- 4.1-2 Property Defined, 4-3
- 4.1-3 Stock Transferred, 4-6
- 4.1-4 Assumption of Liabilities—§ 351-4.10, 4-10
- 4.1-5 Non-Intervenor Transferee Issues, 4-12

4.2 Capital Structure of a Corporation, 4-18

- 4.2-1 Capital Contributions, 4-18
- 4.2-2 Debt in the Capital Structure, 4-19

4.3 Investor Loans, 4-21

- 4.3-1 Stock and Secured Loans, 4-21
- 4.3-2 Business versus Nonbusiness Debt Debts, 4-22
- 4.3-3 Section 163(d) Stock, 4-23

4.4 Gain from Qualified Small Business Stock, 4-24

4.5 Tax Planning, 4-25

- 4.5-1 Holding Period, 4-25
- 4.5-2 Selecting Assets to Transfer, 4-26
- 4.5-3 Debt in the Capital Structure, 4-27
- 4.5-4 Investor Loans, 4-28

THE BIG PICTURE

THE VEHICLE FOR BUSINESS GROWTH IS THE CORPORATION FORM

Emily has operated her startup venture as a sole proprietorship since launching the business two years ago. David, a friend from college, has been collaborating with Emily. Together they have developed an innovative software app. They were overjoyed that as soon as the app was introduced into the market, it was an immediate hit—and it has gained increasing recognition and market traction as sales continue to rise. After only a short period of success though, Emily becomes concerned that the upside potential for even more growth is significant. However, she realizes that a leap to that level of growth and market penetration can only be achieved with a large infusion of capital that she is unable to fund from her resources.

Fortunately, Emily's friend Ethan, who is a venture capitalist, is enthusiastic about making a large investment in the business in exchange for an equity stake. Ethan agrees that Emily's startup easily will enjoy remarkable success once it has the necessary additional resources. To integrate Ethan's capital into the venture, the sole proprietorship will be incorporated with Emily and Ethan each contributing assets in exchange for stock in newly formed Transformation, Inc. Emily also has asked David, an invaluable employee and a major contributor to the app's development, if he would be interested in becoming a shareholder in Transformation. He was given the option of transferring other property or services in exchange for stock. However, at this point, David is undecided about what he will do.

Emily will receive 200 shares of Transformation stock in exchange for transferring the following sole proprietorship assets to the new corporation.

	Adjusted Basis	Fair Market Value
Accounts receivable	\$ 100,000	\$ 100,000
Building	100,000	400,000
Equipment	100,000	100,000
Proprietary information—app	0	1,000,000

Ethan will contribute \$40 million of cash for 4,000 shares of Transformation stock.

What will be the tax and nontax implications arising from the formation of Transformation, Inc.?

Read the chapter and formulate your response.

Concept Summary 4.1

Shareholder Taxable Gains

Amount realized - Adjusted basis of stock transferred = Gain

Loss realized = If amount realized < Adjusted basis of stock transferred

Loss deferred under § 351 = Basis of stock received equals to FMV + deferred loss

4.1b Property Defined

For § 351 purposes, the definition of **property** is comprehensive. For example, along with plant and equipment, uncollected receivables of a cash basis taxpayer and installment notes are considered property.¹⁶ Although the disposition of an installment note receivable normally triggers deferred gain, its transfer under § 351 is not treated as a disposition. As a result, gain is not recognized to the transferee. Proprietary processes and formulas as well as proprietary information in the general nature of a patentable invention also qualify as property under § 351.¹⁷

Section 351 specifically excludes services from the definition of property. No taxpayer must report as income the fair market value of any consideration received as compensation for services.¹⁸ Consequently, when a taxpayer receives stock as consideration for rendering services to the corporation, the income the taxpayer recognizes equals the fair market value of the stock received. This immediate taxation results in a fair market value stock basis for the taxpayer.

EXAMPLE 4

Ann and Bob form Olive Corporation with the transfer of the following consideration:

	Contribution/Transfer	Basis to Transferor	Fair Market Value	Number of Shares
Ann: Personal services rendered to Olive Corporation				
From Bob: Installment note receivable				
Inventory				
Proprietary process				

EXAMPLE 2

Calculating Basis: Shareholder Stock and Corporate Property

Katya and Neil form Brown Corporation. Katya transfers land with a basis of \$100,000 and a fair market value of \$120,000. Neil makes cash contributions. They each receive 50 shares in Brown Corporation worth \$60,000. Neil also receives \$10,000 in cash from Brown.

The transfer of property, the realized and recognized gain on the transfers, and the basis of the stock in Brown Corporation to Katya and Neil are as follows:

	A	B	C	D	E	F
	Basis of Property Transferred	FMV of Stock Received	Realized Gain (B - C)	Recognized Gain (B - C + E)	Basis of Stock in Brown Corporation	Recognized Gain (B - C + E)
From Katya:						
Land	\$100,000	\$120,000	\$20,000	\$40,000	\$100,000	\$10,000
From Neil:						
Cash	60,000	60,000	0	0	60,000	0
Brown Corporation has a basis of \$40,000 in the land (Katya's basis of \$100,000 plus her recognized gain of \$10,000).						

EXAMPLE 3

Assume the same facts as in Example 2, except that Katya's basis in the land is \$60,000 (instead of \$100,000). Because recognized gain cannot exceed realized gain, the transfer generates only \$10,000 of gain to Katya. The realized and recognized gain and the basis of the stock in Brown Corporation to Katya are as follows:

	A	B	C	D	E	F
	Basis of Property Transferred	FMV of Stock Received	Realized Gain (B - C)	Recognized Gain (B - C + E)	Basis of Stock in Brown Corporation	Recognized Gain (B - C + E)
Land	\$60,000	\$120,000	\$60,000	\$10,000	\$60,000	\$10,000
Brown's basis in the land is \$70,000 (\$60,000 basis to Katya + \$10,000 gain recognized by Brown).						

EXAMPLE 4

Exhibit 4.2 summarizes the basis calculation for property received by a corporation. Concept Summary 4.2 shows the shareholder and corporate consequences of a transfer of property to a corporation for stock, with and without the application of § 351. The facts applicable to shareholder Katya's transfer in Example 2 are used to illustrate the differences between the transaction being tax-deferred and taxable.

EXHIBIT 4.2 Corporation's Basis in Property Received

Adjusted basis of property transferred	Less: Gain recognized by transferee-shareholder	Minus: Adjustment for loss property of transferee	Equals: Basis of property to corporation
\$100,000	40,000	0	60,000

EXAMPLE 3

Ann and Cain form Quail Corporation. Ann transfers equipment with an adjusted basis of \$60,000, fair market value of \$80,000, for 20% of the stock, worth \$60,000. Cain transfers equipment with an adjusted basis of \$70,000, fair market value of \$60,000, for the remaining 80% of the stock. The transfers qualify under § 351.

Ann's adjusted basis: \$60,000
Cain's adjusted basis: \$70,000

Equipment FMV (20% of \$140,000): \$28,000
Equipment FMV (80% of \$140,000): \$112,000

Ann's stock basis: \$28,000
Cain's stock basis: \$112,000

In a manner similar to a like-kind exchange, if a taxpayer transfers property to a corporation and receives "boot" (cash or property other than stock), the taxpayer recognizes gain that net loss to the extent of the lesser of the gain realized or the value of the boot received. Any gain recognized is classified (e.g., ordinary capital) according to the type of assets transferred.¹⁹ An discussed in more detail later, the recognition of gain or loss is accompanied by a substituted basis in the shareholder's stock.²⁰ The major shareholder consequences of a taxable property transaction versus one that is tax-deferred are set out in Concept Summary 4.1.

Ann has an unrecognized gain of \$10,000, and Cain has an unrecognized loss of \$10,000. Both have substituted basis in the stock in Quail Corporation. Ann's basis is \$38,000 in her stock, and Cain has a basis of \$102,000 in his stock. Therefore, if either Ann or Cain later disposes of the Quail stock in a taxable transaction (e.g., a sale), this deferred gain/loss will then be fully recognized—a \$30,000 gain to Ann and a \$10,000 loss to Cain.

Alternatively, if Ann and Cain each received Quail stock worth \$60,000 and cash of \$10,000, Ann's realized recognized \$10,000 of the \$10,000 realized gain because she received cash of \$10,000, while Cain's receipt of boot would not trigger recognition of a loss (i.e., recognition of loss never occurs in a § 351 transaction on the receipt of boot). Additional discussion of gain/loss recognition and the basis of stock received appears later in the chapter.

Section 351 is mandatory if a transaction satisfies the provision's requirements. As explained in the following section, the three requirements for nonrecognition of gain or loss under § 351 are that (1) property transferred must be in exchange for stock and (2) the property transfers are in control of the corporation after the exchange. Therefore, if recognition of gain or loss is desired, the taxpayer must fail to meet at least one of these requirements.

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.

iv

Copyright 2020 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. WCN 02-200-203

Copyright 2020 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

COMPUTATIONAL EXERCISES: Students need lots of practice in areas such as computing tax return problems and adjusting rates. We have developed these exercises to give students practice in calculating the solutions they need to make business decisions.

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

Computational Exercises

19. **LO.1** Marie and Ethan form Roundtree Corporation with the transfer of the following. Marie performs personal services for the corporation with a fair market value of \$80,000 in exchange for 400 shares of stock. Ethan contributes an installment note receivable (basis \$25,000; fair market value \$30,000), land (basis \$50,000; fair market value \$170,000), and inventory (basis \$100,000; fair market value \$120,000) in exchange for 1,600 shares. Determine Marie and Ethan's current income, gain, or loss; calculate the basis that each takes in the Roundtree stock.
20. **LO.1** Grady exchanges qualified property, basis of \$12,000 and fair market value of \$18,000, for 60% of the stock of Eadie Corporation. The other 40% of the stock is owned by Pedro, who acquired it five years ago. Calculate Grady's current income, gain, or loss and the basis he takes in his shares of Eadie stock as a result of this transaction.

DATA ANALYTICS

- ❑ Research Problems provide students with vital practice in an increasingly demanded skill area. These end-of-chapter items task students with the analysis of important tax data, with a focus on helping them understand the application of this information in various scenarios. This essential feature will better prepare students for professional tax environments.

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

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

Becker CPA Review Question



1. Paula has sales that qualify to be reported on the installment basis. In year 2, installment sales were \$40,000 with a cost of \$30,000. In year 3, installment sales were \$50,000 with a cost of \$25,000. Collections in year 2 were in the amount of \$30,000. Collections in year 3 were \$10,000 on the year 2 sales and \$30,000 on the year 3 sales. How much deferred gross profit exists as of the end of year 2?
- | | |
|------------|-------------|
| a. \$2,500 | c. \$7,500 |
| b. \$5,000 | d. \$10,000 |



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

THE BIG PICTURE

STRUCTURING ACQUISITIONS

Rock & Water Corporation (R&W) specializes in industrial park landscaping featuring rock walls, holding ponds, water fountains, and indigenous vegetation. One of R&W's central missions is to cause as little negative impact on the environment as possible. Until recently, R&W applied this policy only to its own work, but the new CEO, Tony Turner, wants to extend its corporate responsibility to its suppliers.

R&W uses several types of chemicals and fertilizers in its business and is aware that three of its suppliers do not use environmentally sound practices. Realizing that simply changing suppliers will not eliminate these problematic practices, R&W is considering acquiring these three suppliers. Using this strategy, R&W would control the production practices of these corporations.

R&W is unsure about how to structure these potential acquisitions of its suppliers and seeks your advice. R&W gives you the following information about these potential acquisitions.

- BrineCo is a profitable corporation that has been owned predominantly by the Adams family since its incorporation in 1990. It has virtually no debt because most of its assets date from its incorporation.
- AcidCo, started in 1997, has been having legal troubles and has continually been fined since more stringent EPA standards came into existence. Besides chemicals used by R&W, AcidCo produces acids for the mining industry. R&W is only interested in acquiring the landscaping chemical business.
- ChemCo is a new fertilizer producer with the technology to produce environmentally safe products. Its management is inexperienced, however, and the result has been inefficiencies in production and unintended harm to its surroundings. ChemCo has yet to show a profit.

How will you advise R&W to approach each of these acquisitions?

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 filers. Students will follow this one family, individual, or other taxpayer throughout the chapter showing students how the concepts they are learning play 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.

FINANCIAL DISCLOSURE INSIGHTS:

Tax professionals need to understand how taxes affect the GAAP financial statements. **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.

FINANCIAL DISCLOSURE INSIGHTS **Where Does GAAP Come From?**

Tax law has many sources, including Congress and the legislators of other countries, the courts, and the IRS. Similarly, accounting principles also have many sources. In reconciling the tax and financial accounting reporting of a transaction, the tax professional needs to know the hierarchy of authority of accounting principles so that the proper level of importance can be assigned to a specific GAAP document. The diagram shown below presents the sources of GAAP listed in general order of authority from highest to lowest.

Professional research is conducted to find and analyze the sources of accounting reporting standards in much the same way tax professionals conduct research into open tax questions. In fact, many of the publishers that provide tax research materials also can be used to find GAAP and IFRS documents. The Financial Accounting Standards Board (FASB) also makes its standards and interpretations available by subscription.

Highest Authority	<ul style="list-style-type: none"> • Financial Accounting Standards and Interpretations of the FASB. • Pronouncements of bodies that preceded the FASB, such as the Accounting Principles Board (APB).
	<ul style="list-style-type: none"> • FASB Technical Bulletins. • Audit and Accounting Guides, prepared by the American Institute of CPAs (AICPA) and cleared by the FASB. • Practice Bulletins, prepared by the AICPA and cleared by the FASB.
	<ul style="list-style-type: none"> • Interpretation Guides of the FASB Staff. • Accounting Interpretations of the AICPA. • IASB Accounting Standards. • FASB Concepts Standards. • Widely accepted accounting practices, professional journals, accounting textbooks, and treatises.



ETHICS & EQUITY The Costs of Good Tax Planning

High Tech Tops (HTT), a C corporation based in California, manufactures resilient cases and covers for laptops, smartphones, and tablets. Its sales and profits have more than doubled in each of the last five years (i.e., the company is growth-oriented and recession-proof). Its employees and contractors make above-average wages, so they make important contributions to the local individual income, sales, and property tax collections.

But the Federal and state corporate income tax is another story. Using legal and effective transfer pricing techniques, HTT shifts most of its operating profits to low-tax subsidiaries in Ireland and Singapore. Most of the firm's executives, engineers, and designers are based in the United States, but almost all of the sales operations are run from overseas. HTT's customers live around the

world, but its tax liabilities are concentrated in the low-tax jurisdictions.

You are the president of State University, across town from HTT's headquarters. The company sends hundreds of its employees to take graduate and professional courses on your campus, and several of the corporate leaders are frequent guest speakers and adjunct lecturers in classes.

Still, the state income tax the company avoids through its transfer pricing plans would fund millions of dollars of campus growth and improvements for State University.

Should you become involved in the politics of the matter and lobby at your statehouse for tighter rules on transfer pricing? Such an action might result in tax increases that would improve your university's situation, but it also might force HTT to consider moving its headquarters to another location.

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

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

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

9-8 TAX PLANNING

Return to the timeline of Exhibit 9.6, and consider the decision to operate a multinational business entity as a branch and when to convert the structure of the business to an overseas subsidiary. Exhibit 9.9 identifies the major advantages and disadvantages for each of these decisions from a Federal income tax standpoint.

Additional tax planning opportunities and considerations are discussed below.

9-8a The Foreign Tax Credit Limitation and Sourcing Provisions

The FTC limitation is partially based on the amount of foreign-source taxable income in the numerator of the limitation formula. Consequently, the sourcing of income is extremely important. Generally, in this regard, the U.S. taxpayer benefits when the sourcing rules work to:

- Generate *income* items that are *foreign-source*, to maximize net foreign-source income (the numerator of the FTC fraction). Alternatively, a branch or flow-through entity might want overseas income to be U.S.-source, to increase its 20 percent deduction for qualified business income.⁵⁷
- Realize *deduction* items as *U.S.-source*, to minimize any reduction in net foreign-source income (the numerator of the FTC fraction).



GLOBAL TAX ISSUES Tax Reform Adds a New Wrinkle to the Choice of Organizational Form When Operating Overseas

When the management of a corporation decides to expand its business by establishing a presence in a foreign market, the new business venture may take one of several organizational forms. As each form comes with its respective advantages and disadvantages, making the best choice can be difficult. And the choice is even more difficult now since a new set of rules applies to the taxation of international operations beginning in 2018.

Nonetheless, one common approach is to conduct the foreign activity as a *branch* operation of the U.S. corporation. The foreign branch is not a separate legal entity, but a division of the U.S. corporation established overseas. As a result, any gains and losses produced by the foreign unit are included in the corporation's overall financial results.

Another possibility is to organize the foreign operations as a *subsidiary* of the U.S. parent corporation. If this route is chosen, the subsidiary may be either a *domestic* subsidiary (i.e., organized in the United States) or a *foreign* subsidiary (organized under the laws of a foreign country).

One fundamental tax difference between these two approaches is that the gains and losses of a domestic

subsidiary may be consolidated with the operations of the U.S. parent, but the operations of a foreign subsidiary cannot. Thus, the use of a domestic subsidiary to conduct foreign operations generally yields the same final result as the use of a branch. With both approaches, the financial statements of the U.S. parent reflect the results of its worldwide operations.

As noted, the tax rules associated with international operations and their impact on organizational forms have changed with the passage of the Tax Cuts and Jobs Act (TCJA) of 2017. Now the United States uses a "territorial system" when taxing foreign earnings, which, generally, requires U.S. corporations to pay U.S. tax only on their domestic income. Given the complexity of the organizational form decisions and the significance of the changes to international taxation rules in the TCJA of 2017, it will take time for tax professionals to determine the most tax-effective ways of structuring foreign operations of U.S. corporations. See Chapter 9 for additional discussion of the taxation of international operations.

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

Take your students from Motivation to Mastery with CengageNOWv2

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

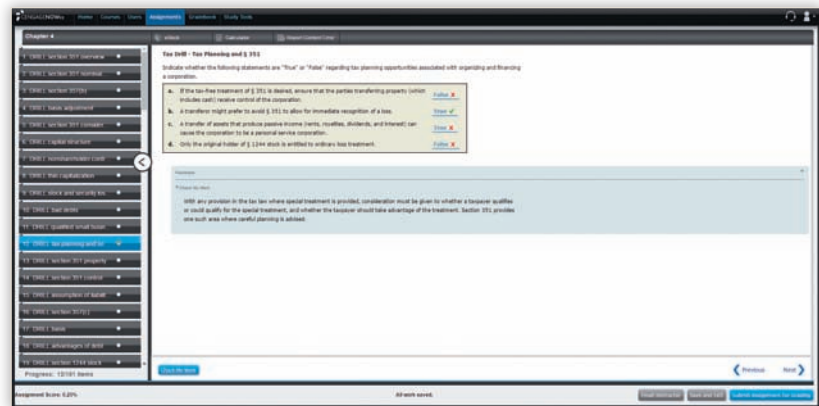


- ❑ **MOTIVATION:** engage students and better prepare them for class
- ❑ **APPLICATION:** help students learn problem-solving behavior and skills to guide them to complete taxation problems on their own
- ❑ **MASTERY:** help students make the leap from memorizing concepts to actual critical thinking

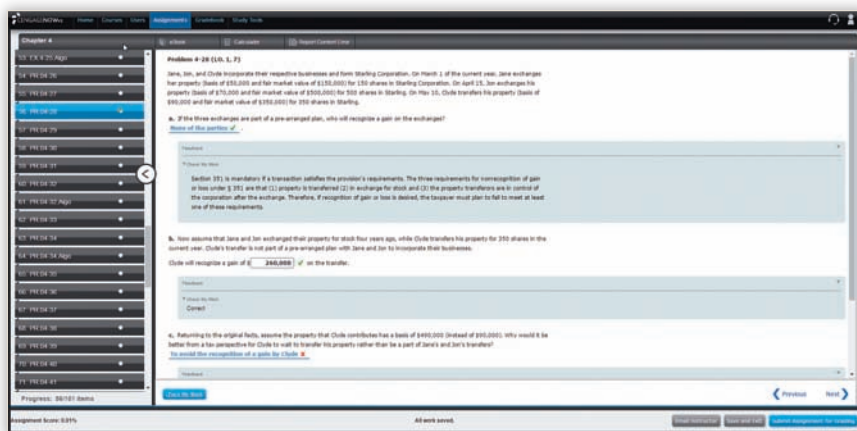
Motivation —

Many instructors find that students come to class unmotivated and unprepared. To help with engagement and preparedness, CengageNOWv2 for SWFT offers:

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



Application —



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

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

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

Mastery —

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

CengageNOWv2 Instant Access Code ISBN:
978-0-357-10952-6

Contact your Cengage Learning Consultant about different bundle options.

The screenshot shows the Intuit ProConnect software interface for completing a 2018 U.S. Income Tax Return for an S Corporation. The main window displays the form title and key information such as the taxpayer's name (Premium, Inc.), address (1000 Main Street, Dallas, TX 75201), and the tax year (2018). The interface is divided into several panes, including a main form area, a sidebar with navigation options, and a top navigation bar. The form is partially filled out, showing fields for the taxpayer's name, address, and business information.

This screenshot shows a different view of the Intuit ProConnect software interface for the 2018 U.S. Income Tax Return for an S Corporation. The main window displays the form title and key information such as the taxpayer's name (Premium, Inc.), address (1000 Main Street, Dallas, TX 75201), and the tax year (2018). The interface is divided into several panes, including a main form area, a sidebar with navigation options, and a top navigation bar. The form is partially filled out, showing fields for the taxpayer's name, address, and business information.

EXTENSIVELY REVISED. DEFINITELY UP TO DATE.

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

The *South-Western Federal Taxation* authors have made every effort to keep all materials up to date and accurate. All chapters contain the following general changes for the 2020 Edition.

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

In addition, the following materials are available online.

- An appendix that helps instructors broaden and customize coverage of important tax provisions of the Affordable Care Act. (Instructor Companion Website at cengage.com/login)
- The Depreciation and the Accelerated Cost Recovery System (ACRS) appendix. (Instructor Companion Website at cengage.com/login)
- The *Taxation in the Real World* weekly blog posts for instructors. (tinyurl.com/swft-blog)

Chapter 1

- Updated references and citations throughout the chapter.
- Modified discussion of the Small Claims Division of the U.S. Tax Court.

- Updated discussion on changes to the CPA Exam.
- Updated end-of-chapter materials as needed.

Chapter 2

- Revised and updated chapter materials based on Final § 199A Regulations released in January 2019. Added materials on (1) the definition of a qualified trade or business and the new rental real estate safe harbor, (2) rules on the aggregation of qualified trades and businesses, (3) implications of losses (and netting requirements), and (4) a new exhibit summarizing specified services businesses.
- Updated chapter materials to reflect inflation adjustments to threshold limits.
- Revised and clarified materials based on feedback from adopters.
- Added new end-of-chapter materials based on the Final § 199A Regulations.

Chapter 3

- Updated chapter materials as needed for new rulings and inflation adjustments.
- Restructured the chapter “Tax Planning” section and added three new topics regarding planning for the business interest expense limitation, executive compensation, and avoiding the accumulated earnings tax.
- Updated end-of-chapter materials as needed.
- Included completed forms (in Solutions Manual) for Tax Return Problems.

Chapter 4

- Combined investor loss and gain provisions into one section.
- Added an example of § 1202 Qualified Small Business Stock exclusion.
- Streamlined and enhanced chapter materials.
- Added an end-of-chapter problem on § 1202 Qualified Small Business Stock exclusion.

Chapter 5

- Revised and updated chapter materials as needed; clarified chapter materials.
- Updated end-of-chapter materials as needed.
- Revised and expanded a Research Problem to include Data Analytics.

Chapter 6

- Added new text material in “Tax Planning—Stock Redemptions” regarding the advantages to corporation and shareholder of debt-financed redemptions.
- Updated and revised end-of-chapter materials as needed.

Chapter 7

- Added an assignment item about post-merger E & P.
- Created one new Research Problem.
- Added a graphics component to one Research Problem.

Chapter 8

- Updated statistics regarding consolidated returns.
- Revised material about advantages and disadvantages of the consolidation election.
- Streamlined material about controlled groups.
- Added one new Microsoft Excel problem.
- Added two Data Analytics Research Problems.

Chapter 9

- Streamlined text Section 9-4 (Foreign Currency Gain/Loss).
- Updated statistics about worldwide tax rates and the global economy.
- Revised overview language and Exhibit 9.2.
- Clarified materials on transfer pricing.
- Added a comment about the FASB treatment of the BEAT tax rate in deriving the deferred tax amounts.
- Reduced discussion of foreign currency gain/loss; added a reference to Bitcoin (and related) currencies.
- Added comments about the application of § 199A and the GILTI computation for flow-through entities.
- Added a Microsoft Excel feature to one problem.
- Added a new Research Problem concerning the international tax implications of the 2017 tax reform provisions.

Chapter 10

- Updated and clarified Global Tax Issues item “Withholding Requirements for non-U.S. Partners.”
- Updated Schedule K-1 to reflect partnership reporting requirements for the qualified

business income deduction, per Form 1065, Schedule K-1.

- Updated Concept Summary 10.3 (Tax Reporting of Partnership Items) to reflect IRS guidance in Regulations and Form 1065 and Schedule K-1.
- Updated and clarified Concept Summary 10.4 (Major Advantages and Disadvantages of the Partnership Form).
- Modified introduction to text Section 10-1b, “Key Concepts in Taxation of Partnership Income.”
- Streamlined discussion of terms such as *inside basis*, *outside basis*, and *separately stated items*.
- Streamlined discussion of gain or loss recognition on formation of a partnership.
- Streamlined discussion of disguised sales.
- Streamlined discussion of carried interests and partnership interests received in exchange for services.
- Streamlined discussion of organization and startup costs.
- Clarified that the \$26 million “average annual gross receipts” test now applies only to the most immediately preceding three-tax-year period rather than all prior three-tax-year periods.
- Streamlined the discussion of “Other Items Reported on Schedule K.”
- Updated and substantially modified discussion of qualified business income to reflect Regulations.
- Updated and clarified discussion in text Section 10-5a, “Choosing Partnership Taxation.”
- Slightly modified fact pattern in Computational Exercise 26 to reflect different profit- and loss-sharing ratios to illustrate differences in recourse and nonrecourse debt allocations.
- Added concept of § 704(b) book capital accounts in Problem 29 to illustrate accounting for pre-contribution gains.
- Added requirement in Problem 31 to address built-in gain on contribution of assets to partnership.
- Replaced Research Problems 2 and 6.

Chapter 11

- Reorganized text Section 11-2 (§ 736) into three new categories.
 - 11-2a, General Partners in Service-Providing Partnerships
 - 11-2b, Limited Partners or Capital-Intensive Partnerships
 - 11-2c, Tax Treatment of § 736 Payments

- Clarified Concept Summary 11.1 and Concept Summary 11.2.
- Streamlined discussions of disguised sales, marketable securities, and disproportionate distributions.
- Refocused and simplified the discussion of § 736 payments.
- Streamlined the discussion related to death of a partner.
- Added requirement to Computational Exercise 11 to calculate partner's basis.
- Added a requirement to Problem 42 to illustrate using a § 754 election to bring inside and outside basis into balance, as shown in Example 34.

Chapter 12

- Updated statistics about S corporations and partnerships/LLCs.
- Clarified materials concerning the QBI regime.
- Added two new Microsoft Excel problems.
- Added two new Research Problems.

Chapter 13

- Converted data about the tax forms of doing business into a graphic.
- Added § 1202 benefit to Concept Summary 13.1 that compares entity types.
- Added a problem about bonus depreciation for various business forms.
- Revised Research Problem about entity taxable receipts.
- Added new Research Problem asking students to look at initial coin offering (ICO) for entity financing.

Chapter 14

- Highlighted the recognition and measurement steps in disclosing tax uncertainties in the financial statements.
- Elaborated the financial accounting income effects of the 2017 corporate tax rate cut.
- Emphasized the effects on a valuation allowance from the changes to the treatment of post-2017 NOLs, and of AMT repeal.
- Noted the different deadlines under tax and financial accounting rules and the need for tax and reporting professionals to work together to meet these requirements.
- Expanded the discussion of planning ideas for releasing a valuation allowance.

- Added a new Critical Thinking Research Problem.
- Replaced one Research Problem.

Chapter 15

- Clarified the purpose of a tax exemption and of Federal taxes on exempt entities in the introductory comments.
- Updated statistics about the charitable sector of the U.S. economy.
- Reorganized the introduction to the discussion of taxes that fall on exempt entities.
- Revised discussion of the taxation of lobbying expenses by a public charity.
- Updated and added to statistics about private foundations and the UBIT.
- Added an additional Microsoft Excel problem.
- Identified two problems as Data Analytics items.

Chapter 16

- Updated statistics as to state and local government tax collections.
- Updated financial statement data for state/local taxes for selected corporations.
- Updated material relative to sales/use tax nexus, in light of the Supreme Court's *Wayfair* decision.
- Identified two Research Problems as Data Analytics items.
- Created two additional Microsoft Excel problems.

Chapter 17

- Updated statistics about IRS budget and personnel, and about tax audits, refunds, and penalties.
- Updated results concerning whistleblowers and informants.
- Updated results of the Taxpayer Attitude Survey.
- Updated user fees for various programs and IRS interest rates on underpayments and overpayments.
- Adjusted various penalty amounts for indexing.
- Added one new Microsoft Excel problem.
- Replaced one Research Problem with another requiring internet research.

Chapter 18

- Updated statistics about Federal estate and gift tax filings and payments.
- Clarified that the chapter uses a flat 40 percent tax rate only as a simplifying assumption; added reference to § 2001 Tax Rate Schedule as reproduced on the inside front cover of the book.

- Added text example illustrating the determination of generations for the GSTT.
- Added another Microsoft Excel problem.
- Designated one problem as a Data Analytics item.

Chapter 19

- Emphasized the importance of planning for the income tax basis consequences of the survivors, given a high exemption equivalent amount.
- Clarified content throughout the chapter, including language regarding special use valuation and the deceased spouse's unused exclusion amount.
- Streamlined Concept Summary 19.1.

- Added two new Microsoft Excel problems.
- Added two new Research Problems, one of which is a Data Analytics exercise.

Chapter 20

- Added references to the NOL deduction limitation, and the deduction for QBI, where the entity operates a trade or business.
- Added item about the fiduciary entity claiming a QBI deduction.
- Added another Microsoft Excel item.
- Designated one Research Problem as a Data Analytics item.

TAX LAW OUTLOOK

From your SWFT Series Editors:

Treasury and the IRS will continue to issue guidance on the Tax Cuts and Jobs Act of 2017 throughout 2019 and beyond. With over 100 changes, this is a time-consuming process. Much of the initial guidance was proposed or transitional. As a result, what applied for one year, might apply the same way in the next year. Whether the 116th Congress will enact any of the over 70 technical corrections identified by the Joint Committee on Taxation in the Bluebook (JCS-1-18; 12/20/18) is unknown due both to challenges of obtaining the necessary 60 votes in the Senate and that the House is controlled by Democrats. The technical corrections are a mix of taxpayer favorable and unfavorable items. States will continue to analyze the effects of the TCJA as they make or revisit conformity considerations.

With respect to sales and use tax, many states have adopted the South Dakota law that was analyzed in the 2018 *Wayfair* decision. Litigation could surface as the 200 or more transactions threshold causes very small sellers to collect use tax. More states are likely to consider enacting marketplace facilitator collection obligations.

Finally, as candidates prepare for the 2020 presidential election, many tax ideas will be suggested. They present opportunities for students and researchers to analyze how they work and how they measure up against principles of good tax policy.

SUPPLEMENTS SUPPORT STUDENTS AND INSTRUCTORS

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

Online and Digital Resources for Students



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

CengageNOWv2 Instant Access Code ISBN:
978-0-357-10952-6

Contact your Cengage Learning Consultant about different bundle options.

THOMSON REUTERS CHECKPOINT™ 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™ (after activation) is packaged automatically with every NEW copy of the textbook.*



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

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

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

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

Online Student Resources

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

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



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

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

Printed Resources for Students

Looseleaf Edition (978-0-357-10925-0)

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

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

Comprehensive Supplements Support Instructors' Needs



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

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

Solutions Manual

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

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

PowerPoint® Lectures with Notes

The Instructor PowerPoint® Lectures contain more than 30 slides per chapter, including outlines and instructor guides, concept definitions, and key points. Available on **Instructor Companion Website at 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 2020 Test Bank is available in Cengage's test generator software, Cognero.

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

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

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

Other Instructor Resources

All of the following instructor course materials are available online at cengage.com/login. Once logged into the site, instructors should select this textbook to access the online Instructor Resources.

- Instructor Guide
- Edition-to-edition correlation grids by chapter
- Detailed answer feedback for the end-of-chapter Becker CPA Review Questions in Word format. (Lettered answers only are available in the Solutions Manual.)
- An appendix that helps instructors broaden and customize coverage of important tax provisions of the Affordable Care Act
- The Depreciation and the Accelerated Cost Recovery System (ACRS) appendix
- Comprehensive Tax Return Problems appendix

Custom Solutions

Cengage Learning Custom Solutions develops personalized solutions to meet your taxation education needs. Consider the following for your adoption of *South-Western Federal Taxation 2020 Edition*.

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

ACKNOWLEDGMENTS

We want to thank all the adopters and others who participated in numerous online surveys as well as the following individuals who provided content reviews and feedback in the development of the ***South-Western Federal Taxation*** 2020 titles.

William A. Raabe / James C. Young / William H. Hoffman, Jr. / Annette Nellen / David M. Maloney

- Lindsay G. Acker, *University of Wisconsin-Madison*
 Deborah S. Adkins, *Nperspective, LLC*
 Mark P. Altieri, *Kent State University*
 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*
 Patrick M. Borja, *Citrus College / California State University, Los Angeles*
 Dianne H. Boseman, *Nash Community College*
 Cathalene Bowler, *University of Northern Iowa*
 Madeline Brogan, *Lone Star College – Montgomery*
 Darryl L. Brown, *Illinois Wesleyan University*
 Timothy G. Bryan, *University of Southern Indiana*
 Robert S. Burdette, *Salt Lake Community College*
 Ryan L. Burger, *Concordia University Nebraska*
 Lisa Busto, *William Rainey Harper College*
 Julia M. Camp, *Providence College*
 Al Case, *Southern Oregon University*
 Machiavelli W. Chao, *Merage School of Business University of California, Irvine*
 Eric Chen, *University of Saint Joseph*
 Christine Cheng, *Louisiana State University*
 James Milton Christianson, *Southwestern University and Austin Community College*
 Wayne Clark, *Southwest Baptist University*
 Ann Burstein Cohen, *University at Buffalo, The State University of New York*
 Ciril Cohen, *Fairleigh Dickinson University*
 Dixon H. Cooper, *University of Arkansas*
 Rick L. Crosser, *Metropolitan State University of Denver*
 John P. Crowley, *Castleton University*
 Susan E. M. Davis, *South University*
 Dwight E. Denman, *Newman University*
 James M. DeSimpelare, *Ross School of Business at the University of Michigan*
 John Dexter, *Northwood University*
 James Doering, *University of Wisconsin – Green Bay*
 Michael P. Donohoe, *University of Illinois at Urbana Champaign*
 Deborah A. Doonan, *Johnson & Wales University*
 Monique O. Durant, *Central Connecticut State University*
 Wayne L. Edmunds, *Virginia Commonwealth University*
 Rafi Efrat, *California State University, Northridge*
 Charles R. Enis, *The Pennsylvania State University*
 Frank J. Faber, *St. Joseph's College*
 A. Anthony Falgiani, *University of South Carolina, Beaufort*
 Jason Fiske, *Thomas Jefferson School of Law*
 John Forsythe, *Eagle Gate College*
 Alexander L. Frazin, *University of Redlands*
 Carl J. Gabrini, *College of Coastal Georgia*
 Kenneth W. Gaines, *East-West University, Chicago, Illinois*
 Carolyn Galantine, *Pepperdine University*
 Sheri Geddes, *Hope College*
 Alexander Gelardi, *University of St. Thomas*
 Daniel J. Gibbons, *Waubensee Community College*
 Martie Gillen, *University of Florida*
 Charles Gnizak, *Fort Hays State University*
 J. David Golub, *Northeastern University*
 George G. Goodrich, *John Carroll University*
 Marina Grau, *Houston Community College – Houston, TX*
 Vicki Greshik, *University of Jamestown College*
 Jeffrey S. Haig, *Santa Monica College*
 Marcy S. Hampton, *University of Central Florida*
 June Hanson, *Upper Iowa University*
 Donald Henschel, *Benedictine University*
 Susanne Holloway, *Salisbury University*
 Susan A. Honig, *Herbert H. Lehman College*
 Jeffrey L. Hoopes, *University of North Carolina*
 Christopher R. Hoyt, *University of Missouri (Kansas City) School of Law*
 Marsha M. Huber, *Youngstown State University*
 Carol Hughes, *Asheville-Buncombe Technical Community College*
 Helen Hurwitz, *Saint Louis University*
 Richard R. Hutaff, *Wingate University*
 Zite Hutton, *Western Washington University*
 Steven L. Jager, *Cal State Northridge*
 Janeé M. Johnson, *University of Arizona*
 Brad Van Kalsbeek, *University of Sioux Falls*
 John E. Karayan, *Woodbury University*
 Carl Keller, *Missouri State University*
 Cynthia Khanlarian, *Concord University*
 Bob G. Kilpatrick, *Northern Arizona University*
 Gordon Klein, *Lecturer, UCLA Anderson School*
 Taylor Klett, *Sam Houston State University*
 Aaron P. Knape, *Peru State College*
 Cedric Knott, *Colorado State University – Global Campus*
 Ausher M. B. Kofsky, *Western New England University*
 Emil Koren, *Saint Leo University*
 Jack Lachman, *Brooklyn College – CUNY*
 Richard S. Leaman, *University of Denver*
 Adena Lejeune, *Louisiana College*
 Gene Levitt, *Mayville State University*
 Teresa Lightner, *University of North Texas*
 Sara Linton, *Roosevelt University*
 Roger Lirely, *The University of Texas at Tyler*
 Jane Livingstone, *Western Carolina University*
 Heather Lynch, *Northeast Iowa Community College*
 Michael J. MacDonald, *University of Wisconsin-Whitewater*
 Mabel Machin, *Florida Institute of Technology*
 Maria Alaina Mackin, *ECPI University*
 Anne M. Magro, *George Mason University*
 Richard B. Malamud, *California State University, Dominguez Hills*
 Harold J. Manasa, *Winthrop University*
 Barry R. Marks, *University of Houston – Clear Lake*
 Dewey Martin, *Husson University*
 Anthony Masino, *East Tennessee State University*
 Norman Massel, *Louisiana State University*
 Bruce W. McClain, *Cleveland State University*
 Allison M. McLeod, *University of North Texas*
 Meredith A. Menden, *Southern New Hampshire University*
 Robert H. Meyers, *University of Wisconsin-Whitewater*
 John G. Miller, *Skyline College*

- Tracie L. Miller-Nobles, *Austin Community College*
- Jonathan G. Mitchell, *Stark State College*
- Richard Mole, *Hiram College*
- David Morack, *Lakeland University*
- Lisa Nash, *University of North Georgia*
- Mary E. Netzler, *Eastern Florida State College*
- Joseph Malino Nicassio, *Westmoreland County Community College*
- Mark R. Nixon, *Bentley University*
- Garth Novack, *Pantheon Heavy Industries & Foundry*
- Claude R. Oakley, *DeVry University, Georgia*
- Al Oddo, *Niagara University*
- Sandra Owen, *Indiana University – Bloomington*
- Vivian J. Paige, *Old Dominion University*
- Carolyn Payne, *University of La Verne*
- Ronald Pearson, *Bay College*
- Thomas Pearson, *University of Hawaii at Manoa*
- Nichole L. Pendleton, *Friends University*
- Chuck Pier, *Angelo State University*
- Lincoln M. Pinto, *DeVry University*
- Sonja Pippin, *University of Nevada – Reno*
- Steve Platau, *The University of Tampa*
- Walfyette Powell, *Strayer University*
- Dennis Price, *Samford University*
- Darlene Pulliam, *West Texas A&M University*
- John S. Repsis, *University of Texas at Arlington*
- John D. Rice, *Trinity University*
- Jennifer Hardwick Robinson, *Trident Technical College*
- Shani N. Robinson, *Sam Houston State University*
- Donald Roth, *Dordt College*
- Richard L. Russell, *Jackson State University*
- Robert L. Salyer, *Northern Kentucky University*
- Rhoda Sautner, *University of Mary*
- Bunney L. Schmidt, *Keiser University*
- Allen Schuldenfrei, *University of Baltimore*
- Eric D. Schwartz, *LaRoche College*
- Tony L. Scott, *Norwalk Community College*
- Randy Serrett, *University of Houston – Downtown*
- Wayne Shaw, *Southern Methodist University*
- Paul A. Shoemaker, *University of Nebraska – Lincoln*
- Kimberly Sipes, *Kentucky State University*
- Georgi Smatrakalev, *Florida Atlantic University*
- Randy Smit, *Dordt College*
- Leslie S. Sobol, *California State University Northridge*
- Marc Spiegel, *University of California, Irvine*
- Teresa Stephenson, *University of Wyoming*
- Beth Stetson, *Oklahoma City University*
- Debra Stone, *Eastern New Mexico University*
- Frances A. Stott, *Bowling Green State University*
- Todd S. Stowe, *Southwest Florida College*
- Julie Straus, *Culver-Stockton College*
- Martin Stub, *DeVry University*
- James Sundberg, *Eastern Michigan University*
- Kent Swift, *University of Montana*
- Robert L. Taylor, *Lees-McRae College*
- Francis C. Thomas, *Richard Stockton College of New Jersey*
- Randall R. Thomas, *Upper Iowa University*
- Ronald R. Tidd, *Central Washington University*
- MaryBeth Tobin, *Bridgewater State University*
- James P. Trebby, *Marquette University*
- 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*
- Mark Washburn, *Sam Houston State University*
- Bill Weispfenning, *University of Jamestown (ND)*
- Andrew L. Whitehair
- Kent Williams, *Indiana Wesleyan University*
- Candace Witherspoon, *Valdosta State University*
- Sheila Woods, *DeVry University, Houston, TX*
- Xinmei Xie, *Woodbury University*
- Thomas Young, *Lone Star College – Tomball*

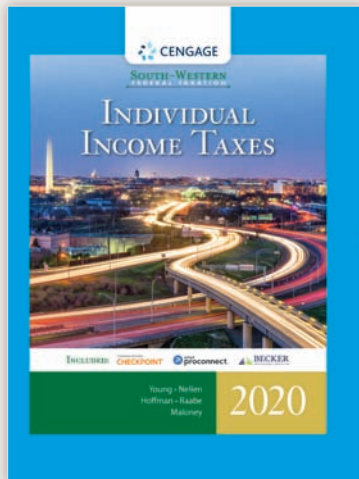
SPECIAL THANKS

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

- Sandra A. Augustine, *Hilbert College*
- Machiavelli Chao, *University of California Irvine*
- Bradrick M. Cripe, *Northern Illinois University*
- Felicia Farrar, *Houston Community College*
- Robyn Dawn Jarnagin, *University of Arkansas*
- Stephanie Lewis, *The Ohio State University*
- Kate Mantzke, *Northern Illinois University*
- Ray Rodriguez, *Murray State University*
- Miles Romney, *Florida State University*
- George R. Starbuck, *McMurry University*
- Lisa Swallow, *Missoula College University of Montana*
- Donald R. Trippeer, *State University of New York College at Oneonta*
- Raymond Wacker, *Southern Illinois University, Carbondale*
- Michael Weissenfluh, *Tillamook Bay Community College*
- Marvin Williams, *University of Houston-Downtown*

The South-Western Federal Taxation Series

To find out more about these books, go to cengage.com.



INDIVIDUAL INCOME TAXES, 2020 EDITION

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

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

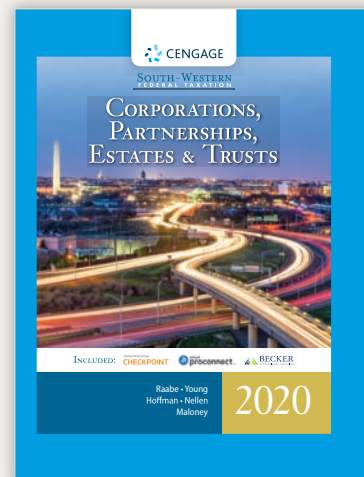
(ISBN 978-0-357-10915-1)

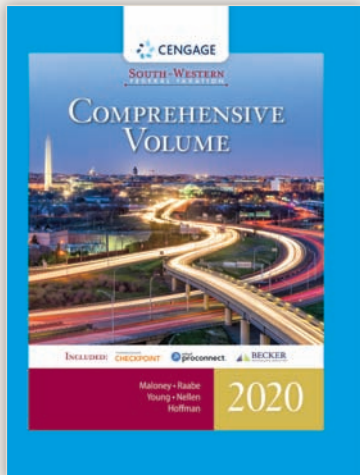
CORPORATIONS, PARTNERSHIPS, ESTATES & TRUSTS 2020 EDITION

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

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

(ISBN 978-0-357-10916-8)





COMPREHENSIVE VOLUME, 2020 EDITION

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

Combining the number one individual tax text with the number one corporations text, *Comprehensive Volume, 2020 Edition* is a true winner. An edited version of the first two *South-Western Federal Taxation* textbooks, this book is ideal for undergraduate or graduate levels. This text works for either a one-semester course in which an instructor wants to integrate coverage of individual and corporate taxation or for a two-semester sequence in which the use of only one book is desired.

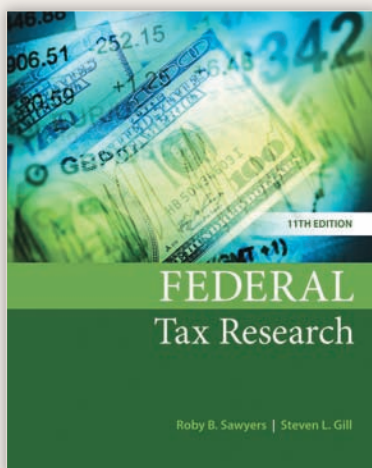
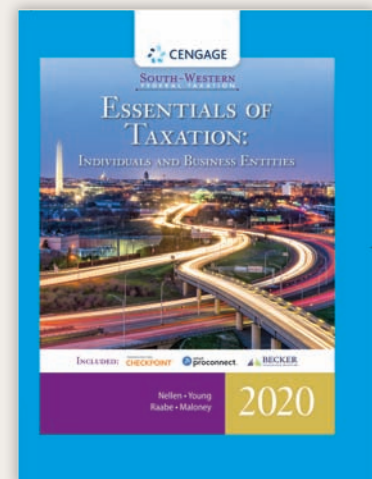
(ISBN 978-0-357-10914-4)

ESSENTIALS OF TAXATION: INDIVIDUALS & BUSINESS ENTITIES, 2020 EDITION

(NELLEN, YOUNG, RAABE, MALONEY, Editors)

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

(ISBN 978-0-357-10917-5)



FEDERAL TAX RESEARCH, 11E

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

(ISBN 978-1-337-28298-7)

ABOUT THE EDITORS



William A. Raabe, Ph.D., CPA, was the Wisconsin Distinguished Professor of Taxation. He taught at Ohio State, Arizona State, the Capital University (OH) Law School, and the Universities of Wisconsin – Milwaukee and 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, and personal financial planning. Dr. Raabe was 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 was 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).

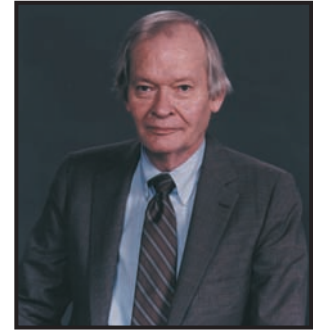


James C. Young is the PwC Professor of Accountancy at Northern Illinois University. A graduate of Ferris State University (B.S.) and Michigan State University (M.B.A. and Ph.D.), Jim's research focuses on taxpayer responses to the income tax using archival data. His dissertation received the PricewaterhouseCoopers/

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

William H. Hoffman, Jr.

earned both his undergraduate (B.A.) and law (J.D.) degrees from the University of Michigan. He completed both an M.B.A. and a Ph.D. at The University of Texas at Austin. Bill began his academic career at Louisiana State University, where he served as a professor of accounting and taxation, before moving to the University of Houston in 1967. Bill remained at Houston for the rest of his academic career, retiring in 1999. Bill published extensively in academic and professional journals. His articles appeared in *The Journal of Taxation*, *The Tax Adviser*, *Taxes—The Tax Magazine*, *The Journal of Accountancy*, *The Accounting Review*, and *Taxation for Accountants*.





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, employment tax, ethics, leadership, and tax policy. Professor Nellen is a graduate of CSU Northridge, Pepperdine

(MBA), and Loyola Law School. Prior to joining SJSU in 1990, she was with a Big 4 firm and the IRS. At SJSU, Professor Nellen is a recipient of the Outstanding Professor and Distinguished Service Awards. Professor Nellen is an active member of the tax sections of the AICPA and American Bar Association. In 2013, she received the AICPA Arthur J. Dixon Memorial Award, the highest award given by the accounting profession in the area of taxation. Professor Nellen is the author of Bloomberg-BNA Tax Portfolio, *Amortization of Intangibles*, and the Bloomberg BNA 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 (21stcenturytaxation.com) as well as websites on tax policy and reform, virtual currency, and state tax issues (sjsu.edu/people/annette.nellen/).



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*.



Brief Contents

PART 1: INTRODUCTION

CHAPTER 1	UNDERSTANDING AND WORKING WITH THE FEDERAL TAX LAW	1-1
CHAPTER 2	THE DEDUCTION FOR QUALIFIED BUSINESS INCOME FOR PASS-THROUGH ENTITIES	2-1

PART 2: CORPORATIONS

CHAPTER 3	CORPORATIONS: INTRODUCTION AND OPERATING RULES	3-1
CHAPTER 4	CORPORATIONS: ORGANIZATION AND CAPITAL STRUCTURE	4-1
CHAPTER 5	CORPORATIONS: EARNINGS & PROFITS AND DIVIDEND DISTRIBUTIONS	5-1
CHAPTER 6	CORPORATIONS: REDEMPTIONS AND LIQUIDATIONS	6-1
CHAPTER 7	CORPORATIONS: REORGANIZATIONS	7-1
CHAPTER 8	CONSOLIDATED TAX RETURNS	8-1
CHAPTER 9	TAXATION OF INTERNATIONAL TRANSACTIONS	9-1

PART 3: FLOW-THROUGH ENTITIES

CHAPTER 10	PARTNERSHIPS: FORMATION, OPERATION, AND BASIS	10-1
CHAPTER 11	PARTNERSHIPS: DISTRIBUTIONS, TRANSFER OF INTERESTS, AND TERMINATIONS	11-1
CHAPTER 12	S CORPORATIONS	12-1

PART 4: ADVANCED TAX PRACTICE CONSIDERATIONS

CHAPTER 13	COMPARATIVE FORMS OF DOING BUSINESS	13-1
CHAPTER 14	TAXES ON THE FINANCIAL STATEMENTS	14-1
CHAPTER 15	EXEMPT ENTITIES	15-1
CHAPTER 16	MULTISTATE CORPORATE TAXATION	16-1
CHAPTER 17	TAX PRACTICE AND ETHICS	17-1

PART 5: FAMILY TAX PLANNING

CHAPTER 18	THE FEDERAL GIFT AND ESTATE TAXES	18-1
CHAPTER 19	FAMILY TAX PLANNING	19-1
CHAPTER 20	INCOME TAXATION OF TRUSTS AND ESTATES	20-1