
Glossary

abandonment loss The unrecovered basis in an abandoned asset. Abandonment losses with respect to business assets are ordinary deductions.

abatement A property tax exemption granted by a government for a limited period of time.

ability to pay Economic resources under a person's control from which they can pay tax.

accelerated death benefits Payments made under a life insurance contract to insured individuals who are terminally or chronically ill.

accrual method of accounting An overall method of accounting under which revenues are realized in the year the earnings process is complete and expenses are matched against revenues in the year the liability for the expense is incurred.

accumulated earnings tax A penalty tax levied on corporations accumulating income beyond the reasonable needs of the business to avoid paying dividends to their shareholders. The tax is levied in addition to the regular income tax.

acquisition debt Debt incurred to acquire, construct, or substantially improve a personal residence. The debt must be secured by the residence and is limited to \$1 million (\$500,000 for married filing separately).

activity-based tax A tax imposed on the results of an ongoing activity in which persons or organizations engage.

ad valorem tax A tax based on the value of property.

adjusted basis The initial tax basis of an asset reduced by cost recovery deductions allowable with respect to the basis.

adjusted gross income (AGI) Total income less adjustments as computed on page 1, Form 1040. AGI is an intermediate step in the calculation of individual taxable income.

adjustments Deductions from total income listed on page 1, Form 1040.

affiliated corporation For purposes of the tax rules governing worthless securities, any 80 percent or more controlled domestic subsidiary that has always derived more than 90 percent of annual gross receipts from the conduct of an active business.

affiliated group A parent corporation and its 80 percent or more controlled subsidiaries.

all-events test The test for determining if an accrued expense is deductible. For most routine accruals, the test is satisfied if the liability on which the accrued expense is based is

fixed and the amount of the liability is determinable with reasonable accuracy.

allowance method The GAAP method for computing bad debt expense. The expense is based on the estimated losses from current year receivables.

alternative minimum tax (AMT) A second federal tax system parallel to the regular tax system. Congress enacted the AMT to ensure that every individual and corporation pays at least a minimal tax every year.

alternative minimum taxable income (AMTI) The tax base for the AMT: regular taxable income increased or decreased by AMT adjustments and increased by AMT tax preferences.

amortization The ratable deduction of the capitalized cost of an intangible asset over its determinable life.

amount realized The sum of any money plus the fair market value of any property received by a seller on the sale or exchange of property.

AMT adjustments Increases or decreases to regular taxable income in the computation of AMTI.

annual gift tax exclusion The first \$10,000 of value that a donor gives to a donee during a calendar year.

annualized income The taxable income reported on a short-period return mathematically inflated to reflect 12 months of business operations.

annuity A cash flow consisting of a constant dollar amount for a specific number of time periods.

apportionment A method of dividing a firm's taxable income among the various states with jurisdiction to tax the firm's business activities.

arm's-length transaction A transaction occurring between unrelated parties who are dealing in their own self-interest.

assignment of income doctrine Income must be taxed to the entity that renders the service or owns the capital with respect to which the income is paid.

average rate The tax rate determined by dividing total tax liability by the total tax base.

bargain element The excess of fair market value over cost of stock acquired on exercise of a stock option.

boot Cash or other nonqualifying property included as part of a nontaxable exchange.

bracket The portion of a tax base subject to a given percentage rate in a graduated rate structure.

bunching A tax planning technique to concentrate itemized deductions into one year so that the total exceeds the standard deduction for the year.

burden of proof The obligation of one party in a legal action to convince the court that the other party is incorrect or unjustified in its assertions of fact.

business purpose doctrine A transaction should not be effective for tax purposes unless it is intended to achieve a genuine and independent business purpose other than tax avoidance.

buy-sell agreement A binding agreement that restricts the conditions and terms under which shareholders may dispose of corporate stock.

cafeteria plan A compensation plan under which employees may choose among two or more benefits, including both cash and noncash items.

calendar year The 12-month period from January 1 through December 31.

capital asset Any asset that does *not* fall into one of five statutory categories: business inventory, business accounts receivable, real or depreciable business property, creative assets, and U.S. government publications.

capital gain or loss Gain or loss realized on the sale or exchange of a capital asset. Capital gain may be eligible for a preferential tax rate.

capitalization An accounting requirement that an expenditure be charged to a balance sheet account rather than against the firm's current income.

carryover basis The basis of transferred property in the hands of the recipient equal to the basis of the property in the hands of the transferor.

cash method of accounting An overall method of accounting under which revenue is accounted for when payment is received and expenses are accounted for when payment is made.

cash surrender value The amount paid to the owner of a life insurance policy on the liquidation of the policy.

centralized management A legal characteristic of the corporate form of business: Corporations are managed by a board of directors appointed by and acting on behalf of the shareholders.

child credit A credit based on the number of the taxpayer's dependent children under age 17.

civil fraud The intention to cheat the government by deliberately understating tax liability.

closely held corporations Corporations privately owned by a relatively small number of shareholders.

collectibles Tangible capital assets such as works of art, antiques, gems, stamps, and coins.

Commerce Clause Article I of the U.S. Constitution that grants the federal government the power to regulate interstate commerce.

consolidated tax return A single Form 1120 reporting the combined results of the operations of an affiliated group of corporations.

constructive dividend A distribution by a corporation to a shareholder that the corporation classifies as salary, interest, rent, or some other type of payment but that the IRS classifies as a dividend.

constructive receipt The point at which a taxpayer has unrestricted access to and control of income, even if the income item is not in the taxpayer's actual possession.

controlled foreign corporation (CFC) A foreign corporation in which U.S. shareholders own more than 50 percent of the voting power or stock value.

controlled group A brother-sister group of corporations owned by the same individual shareholders or a parent-subsidiary group of corporations.

convenience The second standard for a good tax. A tax should be convenient for the government to administer and for people to pay.

correspondence examination The simplest type of audit that can be handled entirely by telephone or through the mail.

cost basis The purchase price of an asset including any sales tax paid by the purchaser and any incidental costs related to getting the asset in place and into production.

cost depletion The method for recovering the capitalized cost of an exhaustible natural resource. Cost depletion equals unrecovered basis in the resource (mine or well) multiplied by the ratio of units of production sold during the year to the estimated total units of production at the beginning of the year.

cost of goods sold The capitalized cost of inventory sold during the taxable year and subtracted from gross receipts in the computation of gross income.

criminal fraud A felony offense involving the willful attempt to evade or defeat any federal tax.

cross-crediting Crediting the excess foreign tax paid in high-tax jurisdictions against the excess limitation attributable to income earned in low-tax jurisdictions.

Cumulative Bulletin (CB) Semiannual compilation of weekly Internal Revenue Bulletins.

declining marginal utility of income The theory that the financial importance associated with each dollar of income diminishes as total income increases.

deduction An offset or subtraction in the calculation of taxable income.

deemed paid foreign tax credit A credit available to U.S. corporations that receive dividends from a foreign subsidiary. The credit is based on foreign income tax paid by the subsidiary.

deferred compensation A nonqualified plan under which an employer promises to pay a portion of an employee's current compensation in a future year.

deferred taxes The balance sheet account that records the difference between tax expense for financial statement purposes and the actual liability computed on the tax return.

deficiency An underpayment of tax determined on audit and assessed by the IRS.

defined-benefit plan A qualified plan under which participants are promised a targeted benefit, usually in the form of a pension, when they retire.

defined-contribution plan A qualified plan under which an annual contribution is made to each participant's retirement account.

dependent A member of a taxpayer's family or household who receives more than half of his or her financial support from the taxpayer.

dependent care credit A credit based on the taxpayer's cost of caring for dependents either under age 13 or physically or mentally incapable of caring for themselves.

depreciation The systematic deduction of the capitalized cost of tangible property over a specific period of time.

depreciation recapture Recapture computed with reference to depreciation or amortization deductions claimed with respect to property surrendered in a sale or exchange.

direct write-off method The method for determining a bad debt deduction required by the tax law. Only receivables that are written off as uncollectible during the year are deductible.

discount rate The rate of interest used to calculate the present value of future cash flows.

discriminate function system (DIF) score A numeric score assigned to individual tax returns that measures the return's potential for generating additional tax on audit.

distributive share A partner's share of any item of income, gain, deduction, or loss recognized by the partnership. Distributive shares are usually expressed as a percentage and specified in the partnership agreement.

dividends-received deduction A corporate deduction equal to a percentage of dividend income received from other taxable, domestic corporations.

donee An individual or organization that receives a gift.

donor An individual who makes a gift.

dynamic forecast A projection of revenue gain or loss resulting from a tax rate change that assumes that the change will affect the tax base.

earmarked tax A tax that generates revenues for a designated project or program rather than for the government's general fund.

earned income credit A refundable income tax credit that offsets the impact of the payroll tax on low-income workers.

economic performance A requirement of the all-events test for nonrecurring, extraordinary accruals. Economic performance means that all activities necessary to satisfy the accrued liability have been completed.

education IRA An investment account through which individuals can save for higher education expenses on a tax-exempt basis.

efficiency The third standard for a good tax. Classical economic theory holds that an efficient tax is neutral and has no effect on economic behavior. In contrast, Keynesian theory holds that an efficient tax is a fiscal policy tool by which the government can affect economic behavior.

employee An individual who performs services for compensation and who works under the direction and control of an employer.

employee payroll tax The FICA tax (Social Security and Medicare tax) levied on employees who receive compensation during the year.

employee stock ownership plan (ESOP) A qualified defined contribution plan in which contributions are invested primarily in the corporate employer's common stock.

employer identification number A number assigned to an employer by the IRS to identify the employer for employment tax purposes.

employer payroll tax The FICA tax (Social Security and Medicare tax) levied on employers that pay compensation during the year.

employer-provided plan A retirement plan sponsored and maintained by an employer for the benefit of the employees.

employment tax A tax based on wages, salaries, and self-employment income. Federal employment taxes are earmarked to fund Social Security and Medicare.

enrolled agent A tax practitioner certified by the IRS to represent clients in IRS proceedings.

event or transaction-based tax A tax imposed on the occurrence of a certain event or transaction.

excess foreign tax credit Foreign tax paid or accrued during the year but not credited against U.S. tax because of the foreign tax credit limitation.

excess payroll tax withholding An overpayment of employee payroll tax allowed as a credit against income tax.

excise tax A tax levied on the retail sale of specific goods or services. An excise tax may be in addition to or instead of a general sales tax.

expansion costs Costs of enlarging the scope of operations of an existing business.

expatriate An individual who is a U.S. citizen and resides and works for an extended period in a foreign country.

explicit tax An actual tax liability paid directly to the taxing jurisdiction.

field examination An audit conducted by a revenue agent at the taxpayer's place of business.

FIFO The inventory costing convention under which the first goods manufactured or purchased are assumed to be the first goods sold.

filing status A classification for individual taxpayers reflecting marital and family situation and determining the rate schedule for the computation of tax liability.

firm A generic business organization. Firms include sole proprietorships, partnerships, limited liability companies, Subchapter S and regular corporations, and any other type of arrangement through which people carry on a profit-motivated activity.

fiscal year Any 12-month period ending on the last day of any month except December.

flat rate A single percentage that applies to the entire tax base.

foreign earned income exclusion An annual amount of foreign source earned income on which expatriates are not required to pay federal income tax.

foreign sales corporation (FSC) An artificial entity through which U.S. firms channel export sales to receive a preferential tax rate on export income.

foreign source income Taxable income attributable to a U.S. firm's business activities carried on in a foreign jurisdiction.

foreign tax credit A credit against U.S. tax based on foreign income tax paid or accrued during the year.

free transferability A legal characteristic of the corporate form of business: Shareholders can buy and sell corporate stock with maximum convenience and minimal transaction cost.

fringe benefits Any economic benefit subject to valuation received by an employee as additional compensation.

general business credit The aggregate of 12 different tax credits available to business enterprises.

general partnership A partnership in which all the partners have unlimited personal liability for the debts incurred by the partnership.

generally accepted accounting principles (GAAP) The set of accounting rules developed by the Financial Accounting Standards Board (FASB) and adhered to by the public accounting profession.

going-concern value Value attributable to the synergism of business assets working in coordination.

goodwill Value created by the expectancy that customers will continue to patronize a business.

graduated rates Multiple percentages that apply to specified brackets of the tax base.

gross income Realized increases in wealth from whatever source derived. In the business context, gross profit from sales of goods, performance of services, and investments of capital.

gross profit percentage The ratio of gain realized to total contract price in an installment sale.

guaranteed payment A distribution from a partnership to a partner to compensate the partner for ongoing services performed for the partnership.

half-year convention Property placed in service on any day of the taxable year is treated as placed in service halfway through the year for MACRS purposes.

head of household Filing status for an unmarried individual who maintains a home for a child or dependent family member.

hobby loss Excess of expenses over revenue from a personal activity not engaged in for profit.

home equity debt Debt secured by a personal residence to the extent the debt does not exceed the owner's equity in the residence. Home equity debt is limited to \$100,000 (\$50,000 for married filing separately).

HOPE scholarship credit An individual tax credit based on tuition and fees paid during the first two years of post-secondary education.

horizontal equity One aspect of the fourth standard of a good tax: A tax is fair if persons with the same ability to pay (as measured by the tax base) owe the same tax.

hybrid method of accounting An overall method of accounting that combines the accrual method for purchases and sales of inventory and the cash method for all other transactions.

implicit tax The reduction in before-tax rate of return that investors are willing to accept because of the tax-favored characteristics of an investment.

imputed income from owner-occupied housing The non-taxable economic benefit (fair rental value) derived by the owner of a home.

incentive stock option (ISO) A qualified stock option for federal tax purposes. Individuals do not recognize the bargain element as income on the exercise of an ISO.

incidence The ultimate economic burden represented by a tax.

income effect A behavioral response to an income tax rate increase: taxpayers engage in more income-producing activities to maintain their level of disposable income.

income tax A tax imposed on the periodic increases in wealth resulting from a person's economic activities.

income tax return preparer Any person who prepares returns (or who employs other people to prepare returns)

for compensation and who is subject to tax return preparer penalties.

income tax treaty A bilateral agreement between the governments of two countries defining and limiting each country's respective tax jurisdiction.

independent contractor A self-employed individual who performs services for compensation and who retains control over the manner in which the services are performed.

individual retirement account (IRA) An investment account through which individuals with compensation or earned income can save for retirement on a tax-deferred basis.

innocent spouse rule The rule of law under which a person who filed a joint return with a spouse is not held liable for any deficiency of tax with respect to the return.

inside buildup Annual increase in value of a life insurance or annuity contract.

installment sale method A method of accounting for gains realized on the sale of property when some part of the amount realized consists of the buyer's note. Under the installment sale method, gain recognition is linked to the seller's receipt of cash over the life of the note.

intangible drilling and development costs (IDC) Expenses such as wages, fuel, repairs to drilling equipment, hauling, and supplies associated with locating and preparing oil and gas wells for production. IDC are deductible for federal tax purposes.

inter vivos transfer A transfer of property occurring during the life of the property owner.

Internal Revenue Bulletin (IRB) The IRS's weekly publication containing revenue rulings and revenue procedures.

Internal Revenue Code of 1986 The compilation of statutory tax laws written and enacted by the Congress of the United States.

Internal Revenue Service (IRS) The subdivision of the U.S. Treasury Department responsible for the enforcement of the federal tax laws and the collection of federal taxes.

investment interest expense Interest paid by an individual on debt incurred to purchase or carry investment property.

involuntary conversion The receipt of insurance or condemnation proceeds with respect to property destroyed by theft or casualty or taken by eminent domain.

itemized deduction An allowable deduction based on an expense or loss incurred by an individual taxpayer that cannot be subtracted in the calculation of AGI.

joint and several liability Each spouse on a joint tax return is individually liable for the entire tax for the year.

joint return A return filed by husband and wife reflecting their combined activities for the year.

jurisdiction The right of a government to levy tax on a specific person or organization.

Keogh plan A qualified retirement plan for self-employed individuals.

key-person life insurance policies Insurance purchased by a firm on the life of a high-level employee. The firm is the beneficiary of the policy.

kiddie tax The tax on a child's unearned income based on the child's parents' marginal rate.

late-filing and late-payment penalty The penalty imposed on taxpayers who fail to file their returns and pay the balance of tax due on a timely basis.

leasehold costs Upfront costs incurred to acquire a lease on tangible business property.

leasehold improvements Physical improvements made by a lessee to leased real property.

leverage The use of borrowed funds to create tax basis.

lifetime learning credit An individual tax credit based on 20 percent of tuition and fees paid for post-secondary education.

lifetime transfer tax exclusion The cumulative amount of property transfers that an individual can make during life or at death without incurring federal transfer tax.

LIFO The inventory costing convention under which the last goods manufactured or purchased are assumed to be the first goods sold.

like-kind property Qualifying business or investment property that can be exchanged on a nontaxable basis.

limited expensing election The election under which firms can expense a limited dollar amount of the cost of tangible personalty placed in service during the taxable year.

limited liability A legal characteristic of the corporate form of business: Corporate shareholders are not personally liable for the unpaid debts of the corporation.

limited liability company (LLC) A form of unincorporated business organization in which the members have limited liability for business debt. LLCs are generally treated as partnerships for federal tax purposes.

limited liability partnership (LLP) A partnership in which the general partners are not personally liable for malpractice-related claims arising from the professional misconduct of another general partner.

limited partnership A partnership in which one or more partners are liable for partnership debt only to the extent of their capital contributions to the partnership. Limited partnerships must have at least one general partner.

long-term capital gain or loss Gain or loss resulting from the sale or exchange of a capital asset owned for more than one year.

marginal rate The tax rate that applies to the next dollar of taxable income.

- market** A forum for commercial interaction between two or more parties for the purpose of exchanging goods or services.
- market discount** The excess of a bond's stated redemption value over the price paid for the bond in a market transaction.
- matching principle** An expense should be taken into account in the period during which the expense contributes to the generation of revenues.
- material participation** An owner's regular, continuous, and substantial involvement in the day-to-day operation of an active business.
- method of accounting** A consistent system for determining the point in time at which items of income and deduction are recognized for tax purposes.
- midmonth convention** Property placed in service on any day of a month is treated as placed in service at the midpoint of the month for MACRS purposes.
- midquarter convention** Property placed in service on any day of a quarter is treated as placed in service at the midpoint of the quarter for MACRS purposes.
- minimum distribution** The annual withdrawal an individual must make from a qualified retirement plan beginning no later than April 1 of the year following the year in which he reaches age 70½.
- minimum tax credit** AMT liability carried forward indefinitely as a credit against future regular tax liability.
- miscellaneous itemized deductions** Itemized deductions that are deductible only to the extent their total exceeds 2 percent of AGI.
- Modified Accelerated Cost Recovery System (MACRS)** The statutory and regulatory rules governing the computation of depreciation for tax purposes.
- moving expenses** The cost of transporting household goods and personal belongings and travel costs incurred in connection with an employment-related move. Moving expenses are an adjustment in computing AGI.
- mutual fund** A diversified portfolio of securities owned and managed by a regulated investment company.
- negative externality** An undesirable by-product of the free enterprise system.
- negligence** Failure to make a prudent attempt to comply with the tax law or the intentional disregard of tax rules and regulations.
- net capital gain** The excess of current year capital gains over capital losses.
- net capital loss** The excess of current year capital losses over capital gains.
- net cash flow** The difference between cash received and cash disbursed.
- net investment income** Income from investment assets reduced by expenses directly related to the production of investment income.
- net long-term gain or loss** Aggregate gain or loss from the sale or exchange of capital assets owned for more than a year.
- net operating loss (NOL)** An excess of allowable deductions over gross income.
- net present value (NPV)** The sum of the present values of all cash inflows and outflows relating to a transaction.
- net short-term gain or loss** Aggregate gain or loss from the sale or exchange of capital assets owned for a year or less.
- nexus** The degree of contact between a business and a state necessary to establish the state's jurisdiction to tax the business.
- NOL carryback** A net operating loss allowed as a deduction in the two years prior to the year of loss.
- NOL carryforward** A net operating loss allowed as a deduction in the 20 years following the year of loss.
- nonbusiness bad debt** An uncollectible debt held by an individual creditor that is unrelated to the individual's business.
- nonprofit corporations** Corporations formed for philanthropic purposes and, as a result, exempt from the federal income tax.
- nonrecourse debt** A debt secured by specific collateral for which the debtor is not personally liable.
- nontaxable exchange** A transaction resulting in realized gain or loss that is not recognized (in whole or part) in the current year.
- offer in compromise** A negotiated settlement with the IRS in which the taxpayer pays less than the entire deficiency.
- office examination** An audit conducted by a tax auditor at an IRS district office.
- ordinary gain or loss** Any realized gain or loss that is not a capital gain or loss.
- ordinary income** Any income that is not capital gain. Ordinary income is taxed at the regular individual or corporate tax rates.
- organizational costs** Expenditures incurred in connection with the formation of a partnership or corporate entity.
- original issue discount (OID)** The excess of a bond's stated redemption value over the issue price.
- outbound transaction** A transaction by which a U.S. firm engages in business in a foreign jurisdiction.
- partnership** An unincorporated association of two or more persons to conduct business as co-owners.
- passenger automobiles** Four-wheeled vehicles manufactured primarily for use on public roads with an unloaded gross vehicle weight of 6,000 pounds or less.
- passive activity** An individual's interest in (1) an active business in which the individual does not materially participate or (2) a rental activity.
- passive income generator (PIG)** An interest in a profitable passive activity.

passthrough entities Business entities that are not taxable entities. The income, gains, deductions, and losses recognized by a passthrough entity are reported by the entity's owners and taxed only once at the owner level.

percentage depletion An annual deduction based on the gross income generated by a depletable property multiplied by a statutory depletion rate.

performance-based compensation Compensation paid solely because the recipient employee attained a performance goal established by a compensation committee of outside members of the corporate board of directors.

permanent difference A difference between financial statement income and taxable income that does not reverse over time.

permanent establishment A fixed location at which a firm carries on its regular commercial activities. For income tax treaty purposes, a country has no jurisdiction to tax a foreign business entity unless the entity maintains a permanent establishment in the country.

personal exemption A dollar amount allowed as a deduction from AGI for each taxpayer and qualifying dependent. The personal exemption is indexed annually for inflation.

personal holding company A corporation owned by a small number of individuals that receives taxable income consisting primarily of nonbusiness income such as dividends, interest, rents, and royalties.

personal holding company tax A penalty tax levied on personal holding companies in addition to the regular corporate income tax.

personal service corporations Closely held corporations owned by individuals who perform services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting for the corporation's clientele. Personal service corporations are subject to a flat 35 percent tax rate.

personalty Any asset that is not realty.

premature withdrawal A withdrawal from a qualified retirement plan made before the individual reaches age 59½.

principal residence The home in which an individual resides for most of the year and considers his permanent address.

private activity bonds Tax-exempt bonds issued by state or local governments for nongovernmental purposes such as industrial development.

private letter ruling The IRS's written response to a taxpayer's inquiry as to how the tax law applies to a proposed transaction.

private market A market in which the parties deal directly with each other and can customize the terms of their agreement to meet their respective objectives.

probate estate Property owned by a decedent and disposed of according to the terms of a valid will or state intestacy laws.

profit-sharing plan A defined-contribution plan under which an employer regularly contributes a percentage of current earnings to the employees' retirement accounts.

progressive rate structure A graduated rate structure with rates that increase as the base increases.

property similar or related in service or use Qualifying replacement property in a nontaxable involuntary conversion.

proportionate rate structure A rate structure with a single, or flat, rate.

public market A market in which the parties deal indirectly through an intermediary such as a broker or a financial institution.

publicly held corporations Corporations with outstanding stock traded on an established securities market.

qualified education loan Any debt incurred to pay higher education expenses. Interest on the debt paid during the first 60 months for which interest is required is eligible for a deduction.

qualified residence interest Interest paid on acquisition debt or home equity debt allowed as an itemized deduction.

qualified retirement plans Retirement plans that meet certain statutory requirements and that allow participants to save for retirement on a tax-deferred basis.

qualified small business stock Stock in a corporate business that meets certain statutory requirements. Individuals who recognize gain on the sale of qualified small business stock may be eligible to exclude 50 percent of the gain from income.

qualifying property The specific property eligible for a particular nontaxable exchange.

real property tax A tax levied on the ownership of realty and based on the property's assessed market value.

realization principle Income is taken into account when the earnings process with respect to the income is complete and an event or transaction occurs that provides an objective measurement of the income.

realized gain or loss The positive or negative difference between the amount realized on the disposition of property and the adjusted basis of the property.

realty Land and whatever is erected or growing on the land or permanently affixed to it.

recapture Recharacterization of Section 1231 or capital gain as ordinary income.

recognition Inclusion of an item of income or deduction in the computation of taxable income.

recognized gain or loss Realized gain or loss taken into account for tax purposes in the current year.

recourse debt A debt for which the debtor is personally liable.

recovery period The number of years prescribed by statute over which the basis of tangible business property is depreciated under MACRS.

regressive rate structure A graduated rate structure with rates that decrease as the base increases.

rehabilitation credit A business credit equal to a percentage of the cost of rehabilitating commercial buildings placed in service before 1936 or certified historic structures.

related party transaction A transaction between parties who share a common economic interest or objective and who may not be dealing at arm's length.

rental activity An activity where payments are principally for the use of tangible property for an extended period of time. Rental activities are passive activities.

reorganization A statutorily defined transaction in which one corporation acquires another, one corporation divides into two corporations, or a corporation changes its capital structure.

revenue Total tax collected by the government and available for public use.

revenue rulings and revenue procedures Published pronouncements explaining how the IRS applies current tax law to a particular set of facts and circumstances.

rollover contribution A distribution from one qualified plan contributed to another qualified plan within 60 days.

Roth IRA An investment account through which individuals with compensation or earned income can save for retirement on a tax-exempt basis.

safe-harbor estimate Estimated current year tax payments based on the preceding year's tax liability that protect the taxpayer from the underpayment penalty.

sales tax A general tax levied on the retail sale of goods and services.

section Numerically labeled subdivision of the Internal Revenue Code. Each section contains an operational, definitional, or procedural rule relating to one of the federal taxes.

Section 1231 asset Real or depreciable property used in a trade or business (including rental real estate) and intangible business assets subject to amortization held by the owner for more than one year.

Section 1244 stock The first \$1 million of stock issued by a corporation for cash or property. Some portion of the loss on the disposition of Section 1244 stock is ordinary to individual investors.

Section 401(k) plan A defined-contribution plan under which employees elect to contribute a portion of current year compensation to an employer-provided retirement plan.

securities Financial instruments including equity interests in business organizations and creditor interests such as savings accounts, notes, and bonds.

self-employment (SE) tax Employment tax levied on an individual's net earnings from self-employment.

seller-financed sale A sale transaction in which the seller accepts the purchaser's debt obligation as part of the sale price.

separate return A return filed by a married individual reflecting his or her independent activity and tax liability for the year. The tax liability is based on the married filing separately rate schedule.

separately stated item An item of income, gain, deduction, or loss recognized by a passthrough entity that retains its character as it flows through to the owners. Separately stated items are not included in the computation of the entity's ordinary business income or loss.

Series EE savings bonds Long-term debt instruments issued by the U.S. government at a discount.

short-period return A tax return for a taxable year consisting of less than 12 months.

short-term capital gain or loss Gain or loss resulting from the sale or exchange of a capital asset owned for one year or less.

single taxpayer An unmarried individual who is neither a surviving spouse nor a head of household.

Small Tax Case division A division of the U.S. Tax Court that holds informal hearings of disputes involving tax deficiencies of \$10,000 or less.

sole proprietorship An unincorporated business owned by one individual.

special agent A revenue agent who handles criminal fraud investigations.

specific identification method An accounting method under which cost of goods sold includes the actual cost of specific items of inventory sold during the year.

standard deduction A deduction from AGI based on filing status. The standard deduction amounts are indexed annually for inflation.

start-up expenditures Up-front costs of investigating the creation or purchase of a business and the routine expenses incurred during the preoperating phase of a business.

static forecast A projection of revenue gain or loss resulting from a tax rate change that assumes that the change will have no effect on the tax base.

statute of limitations The statutory limit on the time period after a tax return is filed during which the IRS can audit the return and assess additional tax.

step transaction doctrine The IRS can collapse a series of intermediate transactions into a single transaction to determine the tax consequences of the arrangement in its entirety.

stock option The right to purchase corporate stock for a stated price (the strike price) for a given period of time.

subchapter S corporation A corporation with a subchapter S election in effect. The corporation is a passthrough entity for federal tax purposes and does not pay federal income tax.

subpart F income A category of foreign source income earned by a CFC constructively distributed to U.S. shareholders in the year earned. Conceptually, subpart F income is artificial income in that it has no commercial or economic connection to the country in which the CFC is incorporated.

substance over form doctrine The IRS can look through the legal formalities to determine the economic substance (if any) of a transaction and to base the tax consequences on the substance instead of the form.

substituted basis The basis of qualifying property received in a nontaxable exchange determined by reference to the basis of the property surrendered in the exchange.

substitution effect A behavioral response to an income tax rate increase: Taxpayers engage in fewer income-producing activities and more nonincome-producing activities.

sufficiency The first standard for a good tax. A tax should generate enough revenue to pay for the public goods and services provided by the government levying the tax.

supply-side economic theory A decrease in the highest income tax rates should stimulate economic growth and ultimately result in an increase in government revenues.

surtax In the corporate context, the extra 5 percent or 3 percent tax imposed to recoup the benefit of the progressive corporate tax rates.

surviving spouse Filing status that permits a widow or widower to use the married filing jointly rate schedule for two taxable years following the death of a spouse.

tax A payment to support the cost of government. A tax is nonpenal but compulsory and is not directly related to any specific benefit provided by the government.

tax assessor An elected or appointed government official responsible for deriving the value of realty located within a taxing jurisdiction.

tax avoidance The implementation of legal strategies for reducing taxes.

tax base An item, occurrence, transaction, or activity with respect to which a tax is levied. Tax bases are usually expressed in monetary terms.

tax basis A taxpayer's investment in any asset or property right and the measure of unrecovered dollars represented by the asset.

tax cost An increase in tax liability for any period resulting from a transaction.

tax credit A direct reduction in tax liability.

tax evasion The willful and deliberate attempt to defraud the government by understating a tax liability through illegal means. Also see *Criminal fraud*.

Tax Expenditures Budget Part of the federal budget that quantifies the annual revenue loss attributable to each major tax preference.

tax haven A foreign jurisdiction with minimal or no income tax.

tax law The body of legal authority consisting of statutory laws, administrative pronouncements, and judicial decisions.

tax planning The structuring of transactions to reduce tax costs or increase tax savings to maximize net present value.

tax policy A government's attitude, objectives, and actions with respect to its tax system.

tax preferences In the general context, provisions included in the federal tax law as incentives to encourage certain behaviors or as subsidies for certain activities. In the AMT context, specific items added to regular taxable income in the computation of AMTI.

tax savings A decrease in tax liability for any period resulting from a transaction.

taxable estate The aggregate fair market value of property owned by a decedent or transferred because of the decedent's death reduced by allowable deductions.

taxable income Gross income minus allowable deductions for the taxable year.

taxpayer Any person or organization required by law to pay tax to a governmental authority.

Taxpayer Bill of Rights Part of the federal law requiring the IRS to deal with every citizen and resident in a fair, professional, prompt, and courteous manner.

temporary difference A difference between financial statement income and taxable income that reverses over time.

tentative minimum tax AMTI in excess of the exemption multiplied by the AMT rates. Any excess of tentative minimum tax over regular tax is the AMT liability for the year.

testamentary transfer A transfer of property occurring on the death of the property owner.

thin capitalization A corporate capital structure with a high ratio of debt to equity.

time value of money A dollar available today is worth more than a dollar available tomorrow because the current dollar can be invested to start earning interest immediately.

total income The sum of the income items recognized by an individual during the year and listed on page 1, Form 1040.

transfer price In the international area, the price at which goods or services are exchanged between controlled corporations operating in different taxing jurisdictions.

transfer tax A tax levied on the transfer of wealth by gift or at death and based on the market value of the transferred assets.

transferee liability Liability of a recipient of property (transferee) for the unpaid tax of the transferor of the property.

treasury regulation The official interpretation of a statutory tax rule written and published by the U.S. Treasury.

28 percent rate gain or loss Long-term capital gain or loss from the sale or exchange of collectibles or qualified small business stock.

U.S. Circuit Courts of Appeals Thirteen federal courts that hear appeals of trial court decisions.

U.S. Court of Federal Claims A federal trial court located in Washington, D.C., in which taxpayers can sue the government for a refund of tax.

U.S. District Courts Federal trial courts in which taxpayers can sue the government for a refund of tax.

U.S. Supreme Court The highest federal court. The Supreme Court hears appeals of circuit court decisions.

U.S. Tax Court A federal court that tries only federal income, gift, and estate tax cases.

underpayment penalty The penalty imposed by the Internal Revenue Code on both individuals and corporations that fail to make required installment payments of current tax on a timely basis.

unemployment tax A tax levied by both the federal and state governments on compensation paid by employers to their employees. Unemployment taxes are earmarked to fund the national unemployment insurance program.

uniform capitalization (unicap) rules The set of tax rules governing the type of current expenditures that must be capitalized to inventory.

Uniform Division of Income for Tax Purposes Act (UDITPA) A model act describing a recommended method

for apportioning a firm's taxable income among multiple state jurisdictions.

unlimited life A legal characteristic of the corporate form of business: A corporation's legal existence is not affected by changes in the identity of its shareholders.

unlimited marital deduction A deduction in the computation of a decedent's taxable estate equal to the value of property transferred to the decedent's surviving spouse.

unrecaptured Section 1250 gain Section 1231 gain on the sale of business realty that would be recaptured as ordinary income under the full recapture rule.

use tax A tax levied on the ownership, possession, or consumption of goods if the owner did not pay the jurisdiction's sales tax when the goods were purchased.

vacation home A personal residence other than the owner's principal residence.

value-added tax (VAT) A tax levied on firms engaged in any phase of the production or manufacture of goods and based on the incremental value added by the firm to the goods.

vertical equity One aspect of the fourth standard of a good tax: A tax is fair if persons with a greater ability to pay (as measured by the tax base) owe more tax than persons with a lesser ability to pay.

wash sale A sale of marketable securities if the seller reacquires substantially the same securities within 30 days after (or 30 days before) the sale.