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# Preface

**P***inciples of Taxation for Business and Investment Planning* is a unique approach to the subject of taxation. This text is designed for use in introductory tax courses included in either undergraduate or graduate business programs. The objective of this text is to teach students to recognize the major tax issues inherent in business and financial transactions. The text focuses on fundamental concepts, the mastery of which provides students with a permanent frame of reference for future study of advanced tax topics. Unlike traditional introductory texts, *Principles of Taxation for Business and Investment Planning* downplays the technical detail that makes the study of taxation such a nightmare for business students. Traditional texts are heavily compliance oriented and convince many students that the tax law is too complex and specialized to be relevant to their future careers. This text attempts to do just the opposite by convincing students that an understanding of taxation is not only relevant but critical to their success in the business world.

*Principles of Taxation for Business and Investment Planning* has its origin in the 1989 White Paper entitled *Perspectives on Education: Capabilities for Success in the Accounting Profession*, published jointly by the Big Eight public accounting firms. The White Paper expressed disenchantment with the narrow technical focus of undergraduate accounting curricula and called for scholastic emphasis on a broad set of business skills necessary for a lifetime of professional success. The Accounting Education Change Commission (AECC), operating under the aegis of the American Accounting Association, embraced the philosophy reflected in the White Paper. In September 1990, the AECC published its Position Statement No. One, entitled *Objectives of Education for Accountants*. This statement reiterated that an undergraduate business education should provide a base on which lifelong learning can be built.

In spite of these calls for reform, many undergraduate tax courses are taught in a traditional manner based on a paradigm developed four decades ago. In the modern (postwar) era of business education, the first generation of tax teachers were practitioners: accountants or attorneys hired as adjunct faculty to initiate students into the mysteries of the newly enacted Internal Revenue Code of 1954. These practitioners taught their students in the same way they trained their employees. In doing so, they created a compliance-oriented paradigm that has survived to the present day. In today's world, this traditional paradigm is an anachronism. Business students don't need to learn how to generate tax information. Instead, they must learn how to use tax information to make good business and financial decisions.

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## A New Paradigm for the Introductory Tax Course

*Principles of Taxation for Business and Investment Planning* provides a paradigm for meeting the educational needs of tax students in the twenty-first century. This paradigm is based on three postulates:

- **Postulate 1: Students should learn the tax law as an integrated component of a complex economic environment.** Students should be aware of the role taxes play in financial and managerial decision making and should understand how taxes motivate people and institutions to engage in certain transactions or activities.
- **Postulate 2: Students should comprehend the tax law as an organic whole rather than as a fragmented collection of rules and regulations.** This postulate dictates that students learn general tax rules rather than the myriad of exceptions that confuse rather than clarify the general rules. They should appreciate how the general rules apply to all taxpaying entities before they learn how specialized rules apply to only certain entities. Finally, they should learn how the law applies to broad categories of transactions rather than to a particular transaction.
- **Postulate 3: Students who learn fundamental concepts have a permanent frame of reference into which they can integrate the constant changes in the technical minutia of the law.** The rapid evolution of the tax law results in a short shelf life for much of the detailed information contained in undergraduate tax texts. Yet the key elements of the law—the statutory and judicial bedrock—do not change with each new revenue act passed by Congress. The student who masters these key elements truly is prepared for a lifetime of learning.

As a teacher with more than 25 years of experience, I know that traditional paradigms die hard and educational reform can be both painful and costly. Nevertheless, I also believe that change in the way college and university professors teach tax is both inevitable and worthwhile. Our responsibility to our students is to prepare them to cope in a business world with little tolerance for outdated skills or irrelevant knowledge. My hope is that *Principles of Taxation for Business and Investment Planning* is a tool that can help us all fulfill that responsibility.

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## Organization and Content

*Principles of Taxation for Business and Investment Planning* consists of six parts with a total of 17 chapters. The following summaries of each part describe the sequencing and content of the chapters.

**Part One, Exploring the Tax Environment,** consists of two chapters that familiarize students with the global tax environment. Chapter 1 describes the environment in terms of the legal relationship between taxes, taxpayers, and governments. Definitions of key terms are developed, and the major taxes that businesses routinely encounter are identified. Chapter 2 considers the tax environment from a normative perspective by asking the question: “What are the characteristics of a good tax?” Students are introduced to the notions of tax efficiency and tax equity and learn how contrasting political beliefs about efficiency and equity continue to shape the tax environment.

**Part Two, Fundamentals of Tax Planning,** concentrates on developing a methodology by which to incorporate tax factors into business decisions. Chapter 3 introduces the pivotal role of net present value of cash flows in evaluating financial alternatives. Students learn how to compute tax costs and tax savings and how to interpret these numbers as cash flows. Chapter 4 covers the basic maxims of income tax planning. The characteristics of the tax law that create planning opportunities are explained, and the generic techniques for taking advantage of those opportunities are analyzed.

**Part Three, The Measurement of Taxable Income**, focuses on the quantification of taxable income generated by business operations. Chapter 5 covers the computation of taxable income or loss from ongoing commercial activities, with special emphasis on differences between taxable income and net income for financial statement purposes. Chapters 6 and 7 explore the tax implications of acquisitions and dispositions of business property, while Chapter 8 is devoted to nontaxable exchanges.

**Part Four, The Taxation of Business Income**, teaches students how to calculate the tax on a given amount of business income. Chapter 9 describes the function of sole proprietorships, partnerships, LLCs, and S corporations as conduits of income, while Chapter 10 discusses corporations as taxable entities in their own right. Chapter 11 builds on the preceding two chapters by exploring the tax planning implications of the choice of business entity. Chapter 12 broadens the discussion by considering the special problems of businesses generating income in more than one tax jurisdiction. This chapter introduces the reader to both multistate and international tax planning strategies.

**Part Five, The Individual Taxpayer**, concentrates on the tax rules and regulations unique to individuals. Chapter 13 presents the individual tax formula and acquaints students with the complexities of computing individual taxable income and tax liability. Chapter 14 covers compensation and retirement planning. Chapter 15 discusses the tax consequences of investment and rental activities and introduces wealth transfer planning. Finally, Chapter 16 analyzes the tax consequences of personal activities, with particular emphasis on home ownership.

**Part Six, The Tax Compliance Process**, consists of Chapter 17, which presents the important procedural and administrative issues confronting taxpayers. This chapter covers the basic rules for the payment of tax and the filing of returns, as well as the penalties the Internal Revenue Service may impose on taxpayers who violate the rules. Chapter 17 also describes the judicial process through which taxpayers and the IRS resolve their differences.

**Tax Research** is an appendix that provides a succinct overview of the tax research process and is designed to prepare students to solve the research problems included at the end of each chapter. The appendix identifies and explains the six steps in the tax research process and contains a cumulative example of the application of each step to a research case.

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## Chapter Highlights

The chapters begin with **Learning Objectives** that preview the technical content and alert students to the important concepts to be mastered. These objectives appear again as marginal notations marking the place in the chapter where each learning objective is addressed. The chapters contain numerous **examples** and **cases** illustrating the topic or demonstrating the calculation under discussion. End-of-chapter materials begin with a list of **Key Terms** from the chapter. Definitions of the key terms from all the chapters are compiled in a **Glossary** for the text. The end-of-chapter materials also include five types of problems for instructors to assign for class discussion or for homework.

- **Questions and Problems for Discussion** challenge students to think critically about conceptual and technical issues covered in the chapter. These problems tend to be open-ended and are designed to engage students in debate. Many problems require students to integrate material from previous chapters in formulating their responses.

- **Application Problems** give students practice in applying the technical material covered in the chapter. Most of the problems are quantitative and students must perform a calculation (or a series of calculations) to derive a numeric solution to the problem.
- **Issue Recognition Problems** are designed to develop students' ability to recognize the tax issues suggested by a set of facts and to state those issues as questions. The technical issues buried in these problems typically are *not* discussed in the chapter. Consequently, the students must rely on their understanding of basic principles to analyze the problem, spot the tax concern or opportunity, and formulate the question to be resolved. In short, students must take the first steps in the tax research process to respond to these problems.
- **Research Problems** provide further opportunity for students to develop their analytic skills. These problems consist of short scenarios that suggest one or more tax issues. The scenarios conclude with explicit research questions for the students to answer. To find the answers, students need access to either a traditional or an electronic tax library. Instructors who assign the research problems can refer their students to **Appendix C**, which provides an overview of the tax research process.
- **Tax Planning Cases** give students an opportunity to integrate their tax knowledge into a business planning framework. Most cases involve taxpayers who must decide whether to undertake a certain transaction or who must choose between alternative transactions. Students must assume the role of tax advisor by analyzing the case and recommending a course of action to maximize the after-tax value of the transaction.

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## Supplemental Materials

An **Instructor's Manual** includes a course outline, topics for class discussion, and teaching hints for a one-semester introductory tax course. The Instructor's Manual also provides suggested solutions to all end-of-chapter problems and cases.

A **Web Page**, prepared by Will Yancey, includes relevant links for each chapter. Power-Point slides are prepared by Lillian Mills (University of Arizona).

A **Test Bank**, prepared by Roxanne Spindle (Virginia Commonwealth University), contains multiple-choice, true-false, and short problems requiring analysis and written answers.

**Computest** is a computerized version of the manual test bank for more efficient use, available in a Windows platform.

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## Using This Text in a First-Semester Tax Course

*Principles of Taxation for Business and Investment Planning* is designed for use in a one-semester (15-week) introductory tax course. Instructors can choose which of the 17 chapters in the book deserve a full week's coverage and which can be covered in less than a week. Instructors may even decide to omit chapters that seem less relevant to the particular educational needs of their students. Business students who complete a one-semester course based on this text will be well prepared to function in the modern tax

environment. If they are required (or may elect) to take a second tax course, they will have a solid, theoretical foundation on which to build. The second tax course typically involves an in-depth study of the taxation of business entities: C corporations, partnerships, LLCs, and S corporations. Because *Principles of Taxation for Business and Investment Planning* puts so much emphasis on the essential tax consequences of business transactions, students who learn from this text should easily make the transition to an advanced tax course.

The content and organization of this text are highly compatible with the Model Tax Curriculum proposed by the American Institute of Certified Public Accountants in 1996. According to the AICPA, the introductory tax course should expose students to a broad range of tax concepts and emphasize the role of taxation in the business decision-making process. Under the model curriculum, students first learn to measure the taxable income generated by business and property transactions. They are then introduced to the different types of business entities and the tax considerations unique to each type. Individual taxation should be one of the last topics covered in the course, rather than the primary focus of the course. Because *Principles of Taxation for Business and Investment Planning* reflects this recommended pedagogical approach, the text is ideal for courses based on the AICPA Model Tax Curriculum.

This is the fifth annual edition of *Principles of Taxation for Business and Investment Planning*. I've been a student of the tax law far too long to believe that this edition is free from technical error or includes every relevant topic. I'm certain that adopters of the text will have many excellent suggestions as to how I can improve the next edition. I welcome any and all comments and encourage my fellow teachers to e-mail me (smj7q@virginia.edu) with their input.

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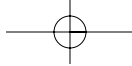
## Acknowledgments

I want to thank the many friends and colleagues who continue to share their ideas for this textbook. I particularly want to acknowledge the contribution of Professor Pat Wilkie and Professor Jim Young at George Mason University. Their article entitled "Teaching the Introductory Tax Course: A Template of the Federal Income Tax Formula, Taxpayer Activities, and Taxpayer Entities" in the *Journal of the American Taxation Association* (Fall 1997), profoundly influenced my thinking and the final organization of this book. Thanks also to the following individuals who reviewed this and the previous edition of the text. Their expert comments were invaluable and this edition is significantly improved because of their involvement.

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I am grateful to the entire McGraw-Hill/Irwin team for their professional support. In particular, I want to acknowledge Jeff Shelstad, Laura Griffin, and my new developmental editor Gail Korosa. Finally, I want to thank my daughter Rachael, who took over the management of the Jones household so that I could write this text.

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