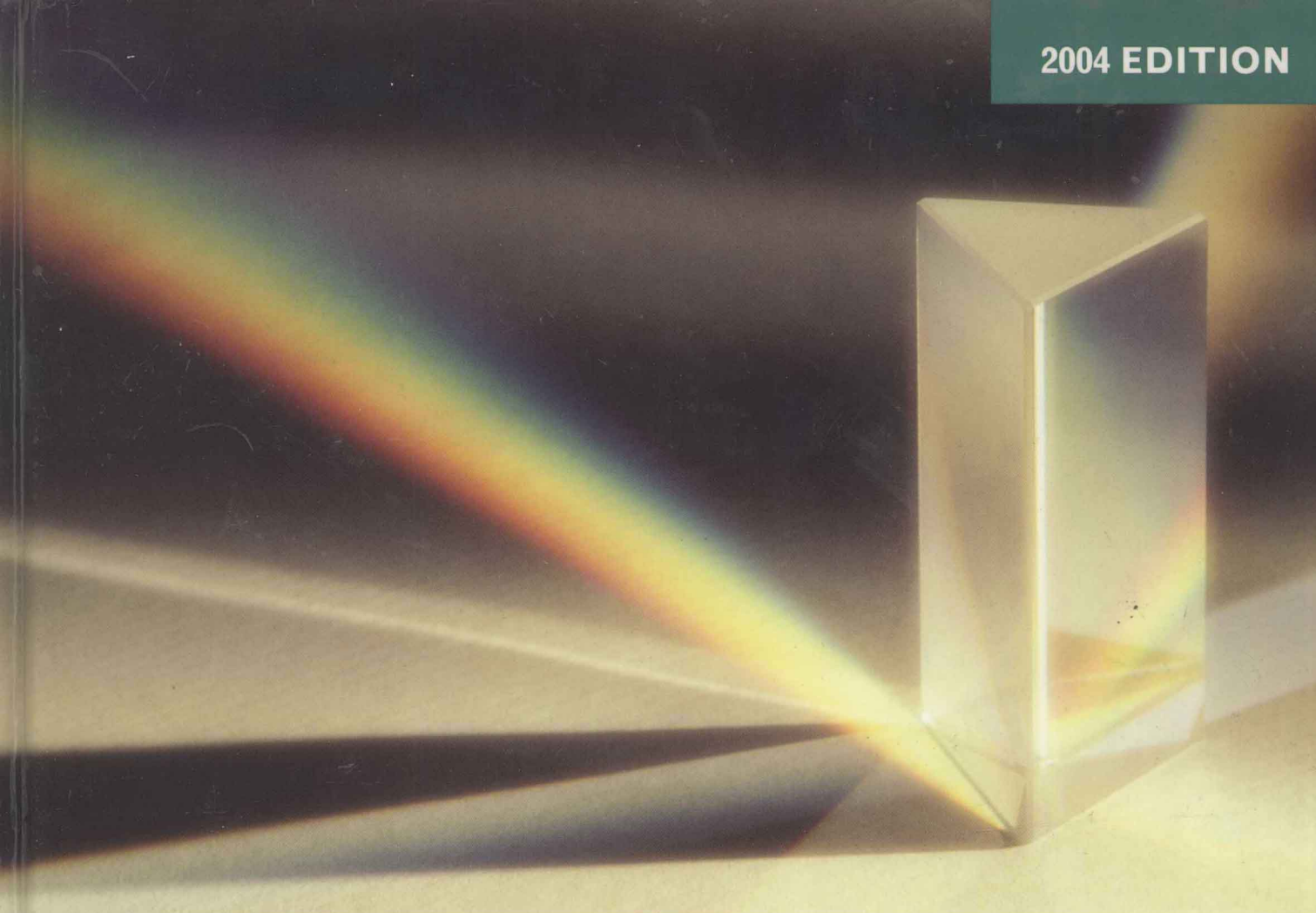


2004 EDITION



# Principles of Taxation

## **ADVANCED STRATEGIES**

Sally M. Jones

Shelley C. Rhoades-Catanach

# Principles of Taxation

**Advanced Strategies**

2004 Edition

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# Principles of Taxation

Advanced Strategies

To my parents, Tom and Betty Morrow

Sally M. Jones

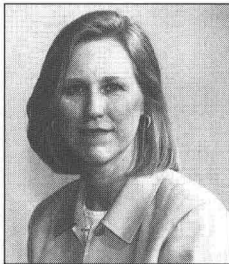
To my husband, Anthony, and my parents,  
Ira and Rochelle Rhoades

Shelley C. Rhoades-Catanach

# About the Authors



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# Preface

In 1997, McGraw-Hill/Irwin published *Principles of Taxation for Business and Investment Planning* to provide tax educators with an innovative alternative to traditional textbooks. *Principles* had its origin in the 1989 White Paper entitled *Perspectives on Education: Capabilities for Success in the Accounting Profession* published jointly by the (then) Big Eight public accounting firms. The White Paper expressed disenchantment with the narrow focus of undergraduate accounting curricula and called for scholastic emphasis on a broad set of business skills that are 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. 1, *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 compliance-oriented paradigm. In today's world, this traditional paradigm is an anachronism. Most business students do not need to learn how to generate tax information. Instead, they must learn to assess the reliability of tax information generated by tax specialists and to use the information to make good business decisions. *Principles* reflects this fundamental shift in the focus of tax education, and instructors who have adopted it for their introductory tax course are enthusiastic about its conceptual approach and emphasis on the role of taxes in the decision-making process. However, many business schools offer both an introductory and an advanced tax course in their accounting curricula. Instructors who use *Principles* have been frustrated by the lack of a follow-up text for the second course. Many instructors have expressed a need for a textbook that reflects the pedagogical philosophy of *Principles* in the coverage of advanced tax topics.

In response to market demand, *Principles of Taxation: Advanced Strategies* was developed to provide coverage of advanced tax topics. This book is ideal for students who studied *Principles of Taxation for Business and Investment Planning* in their introductory course. The two textbooks provide an integrated two-semester sequence of topics that represent a complete educational package for tax students. Nevertheless, *Advanced Strategies* is written in a self-contained manner. Although its approach is consistent with that of *Principles*, its technical content builds on knowledge that students should have acquired from their introductory tax course regardless of the textbook used.

## ORGANIZATION AND CONTENT

*Advanced Strategies* explores the tax consequences of many sophisticated business, financial, and personal wealth-planning transactions. Each transaction is presented in an economic or legal context, and the nontax motives of the transacting parties are examined before the tax issues are identified. The discussion of tax issues emphasizes the development and implementation of strategies to make transactions as tax efficient as possible to all parties involved. Many of the tax strategies are analyzed in terms of their impact on net cash flows and on the income statements and balance sheets of the transacting parties.

All technical topics specified in the AICPA's Model Curriculum for the second semester (advanced) tax course are included in *Advanced Strategies*. These topics are not organized

in the traditional entity-by-entity manner, however, but are organized functionally, according to the type of transactions characteristic of each stage in the evolution of a business from formation through liquidation. This functional organization provides a context to help students appreciate the rationale behind complicated technical provisions. The functional organization should also help students recognize common themes that unite many apparently unrelated rules and regulations and thereby increase their understanding of the basic structure of the tax law.

*Advanced Strategies* is designed for use in a one-semester (15-week) advanced tax course at either the undergraduate or graduate level. Instructors can choose which of the 16 chapters in the book deserve a full week's coverage, which can be covered in less time, and which might be omitted based on the particular educational needs of their students. The following summaries of the six parts of the text describe the sequencing and content of the chapters.

**Part One, Strategic Tax Planning**, consists of Chapter 1, which examines fundamental tax planning ideas. It reviews the business decision-making process, net present value concepts, and the impact of taxation on the maximization of after-tax value. Four basic maxims of tax planning are explained and illustrated with examples drawn from topics covered in the typical introductory tax course.

**Part Two, Tax Strategies for New Businesses**, considers tax planning opportunities related to the formation of business entities. Chapter 2 explores the tax aspects of the choice of organizational form and the contribution of cash or property by the owners to their new entity. Chapter 3 focuses on compensation strategies, including the use of fringe benefits and deferred compensation arrangements, and the contribution of services in exchange for corporate stock or partnership interests.

**Part Three, Business Operating Strategies**, considers tax and accounting issues that affect routine business operations. Chapter 4 focuses on the measurement of annual income and analyzes many of the differences in the computation of book income and taxable income. Chapter 5 examines a variety of tax incentives provided by existing law to encourage specific economic activities. The chapter considers the effect of these incentives on investment decisions as well as the potential alternative minimum tax cost for businesses that take advantage of tax incentives. Chapter 6 addresses tax issues unique to passthrough entities, including the measurement and characterization of income at the entity level and the allocation and reporting of that income to the owners. Chapter 7 examines the tax consequences of distributions of cash or property from both taxable corporations and passthrough entities to their owners.

**Part Four, Strategies for Business Growth and Expansion**, concerns the tax issues involved in the growth and expansion of business enterprises. Chapter 8 considers the use of multiple entities to provide the structure for business expansion. The chapter includes a broad overview of the topic of consolidated corporate tax returns. Chapter 9 considers the multistate tax implications of geographic expansion, and Chapter 10 concentrates on tax strategies that facilitate business expansion on an international scale.

**Part Five, Business Capital Transactions**, examines the tax consequences of capital transactions that change the ownership structure of business enterprises. Chapter 11 explores the tax consequences of sales and redemptions of corporate stock and partnership interests. Chapter 12 discusses both taxable and tax-deferred corporate acquisitions, mergers, and divisions. Chapter 13 addresses the tax issues faced by financially distressed companies and the tax consequences of business liquidations and terminations.

**Part Six, Personal Wealth Planning**, focuses on the transfer tax system and its impact on preserving family wealth. Chapter 14 covers the basic concepts and computations of the gift, estate, and generation-skipping transfer taxes. This chapter also discusses the policy rationale for the transfer tax system and the current political debate surrounding the



prospective repeal of the estate and generation-skipping transfer taxes in 2010. Chapter 15 describes the use of trusts in personal wealth planning and the income tax treatment of trusts, estates, beneficiaries, and decedents. Chapter 16 applies transfer and income tax concepts to develop strategies for the preservation of family wealth and the transfer of family assets, including closely held businesses.

*Advanced Strategies* also includes **Appendix C, Tax Research**, which describes the six steps in the tax research process. It provides examples applying each step of the research process to hypothetical tax research questions.

## CHAPTER HIGHLIGHTS

Each chapter begins with **Learning Objectives** that preview the major concepts to be covered. These objectives also appear in marginal notations throughout the chapter, indicating the specific place where each learning objective is addressed. The chapters contain numerous examples illustrating the concept or demonstrating the calculation being discussed. End-of-chapter materials begin with a list of **Key Terms** from the chapter. Definitions of the key terms from all chapters and Appendix C are compiled in the **Glossary**. The end-of-chapter materials also include five types of problems for in-class or homework assignments.

- **Questions and Problems for Discussion** challenge students to think critically about conceptual and technical issues covered in the chapter. These problems are often open ended and are intended to promote debate.
- **Application Problems** give students practice in applying the material covered in the chapter. Most of these problems are quantitative and require calculations to derive a numeric solution to the problem.
- **Issue Recognition Problems** challenge students to identify tax issues suggested by a set of facts and to state those issues as research questions. The technical issues buried in these problems may not be discussed in the chapter. Students must use their conceptual knowledge to analyze the fact situation, spot the tax problem or opportunity, and formulate the question to be resolved. These problems help students take the first step in the tax research process.
- **Research Problems** provide another opportunity for students to develop their research skills. These problems consist of short scenarios suggesting one or more tax questions. To find the answers, students need access to either a traditional or an electronic tax library. **Appendix C** can aid students in solving these research problems.
- **Tax Planning Cases** give students a chance to integrate their tax knowledge into a business or personal wealth-planning situation. Most cases involve taxpayers deciding whether to undertake a transaction or choosing between alternative transactions. Students assume the role of tax adviser by analyzing the case and recommending a choice of action to maximize the after-tax value of the transaction.

## SUPPLEMENTARY MATERIALS

Supplements are difficult to write and require enormous amounts of time. We are thankful to the authors who helped us with these valuable resources. All are available on the Instructor CD-ROM (ISBN 0072553561) that accompanies the text. The following materials supplement *Principles of Taxation: Advanced Strategies*:

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

The **Test Bank**, prepared by James Fellows, of the University of South Florida, contains multiple choice, true-false, and short problems requiring analysis and written answers. It is available as a Word file and in a computerized version on the Instructors CD-ROM.

The **web page** for the book ([www.mhhe.com/business/accounting/sjones2004](http://www.mhhe.com/business/accounting/sjones2004)) provides a wealth of information for instructors and students. Relevant web links and research projects for each chapter were prepared by William Dellinger. The online quizzes were prepared by James Fellows of the University of South Florida, and the PowerPoint slides were done by Richard Leaman of the University of Denver. These supplements are also available on the Instructor CD-ROM available with the text (ISBN 0072553561).

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*Villanova University*



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**Advanced Strategies**

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