



Pool Canvas

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Name CHAPTER 1--AN INTRODUCTION TO TAXATION AND UNDERSTANDING THE FEDERAL TAX LAW

Description

Instructions

[Modify](#)

[Add Question Here](#)

Question 1

Question

The ratification of the Sixteenth Amendment to the U.S. Constitution was necessary to validate the Federal income tax on corporations.

Answer

True

✓ False

Correct Feedback

The Sixteenth Amendment validated only the tax on *individuals*. The income tax on corporations had been previously sanctioned by the courts.

Incorrect Feedback

The Sixteenth Amendment validated only the tax on *individuals*. The income tax on corporations had been previously sanctioned by the courts.

[Modify](#)

[Remove](#)

[Add Question Here](#)

Question 2

Question

Before the Sixteenth Amendment to the Constitution was ratified, there was no valid Federal income tax on individuals.

Answer

True

✓ False

Correct Feedback

There existed a Federal income tax during the Civil War that was sanctioned by the U.S. Supreme Court.

Incorrect Feedback

There existed a Federal income tax during the Civil War that was sanctioned by the U.S. Supreme Court.

[Modify](#)

[Remove](#)

[Add Question Here](#)

Question 3

Question

The first income tax on individuals (after the ratification of the Sixteenth Amendment to the Constitution) levied tax rates from a low of 2% to a high of 6%.

Answer

✓ True

False

[Modify](#)

[Remove](#)

[Add Question Here](#)

Question 4

Question

The Federal income tax on individuals generates more revenue than the Federal income tax on corporations.

Answer

✓ True

False

[Modify](#)

[Remove](#)

[Add Question Here](#)

Question 5

Question

The pay-as-you-go feature of the Federal income tax on individuals conforms to Adam Smith's canon of certainty.

Answer

True

✓ False

Correct Feedback

Pay-as-you-go refers to the withholding provisions applicable to wages and other types of income and adds *convenience* to the tax system.

Incorrect Feedback

Pay-as-you-go refers to the withholding provisions applicable to wages and other types of income and adds *convenience* to the tax system.

[Modify](#)

[Remove](#)

[Add Question Here](#)

Question 6

Question

Because the law is complicated, most individual taxpayers are not able to complete their Federal income tax returns without outside assistance.

Answer

✓ True

False

Correct Feedback

Approximately 64% use tax return preparers, while slightly more than 20% purchase tax return software.

Incorrect Feedback

Approximately 64% use tax return preparers, while slightly more than 20% purchase tax return software.

[Modify](#)

[Remove](#)

[Add Question Here](#)

Question 7

Question

The FICA tax (Medicare component) on wages is *progressive* since the tax due increases as wages increase.

Answer

True

✓ False

Correct Feedback

The FICA tax (Medicare component) is *proportional* because the rate is constant regardless of the wages earned.

Incorrect Feedback

The FICA tax (Medicare component) is *proportional* because the rate is constant regardless of the wages earned.

[Modify](#)

[Remove](#)

[Add Question Here](#)

Correct Feedback The Federal government relies on an estate tax while states impose an estate tax, an inheritance tax, both taxes, or neither tax.

Incorrect Feedback The Federal government relies on an estate tax while states impose an estate tax, an inheritance tax, both taxes, or neither tax.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 25 ▾ True/False

Question

An inheritance tax is a tax on a decedent's right to pass property at death.

Answer True
 False

Correct Feedback What is described is an estate tax. An inheritance tax is a tax on an heir's right to receive property from a decedent.

Incorrect Feedback What is described is an estate tax. An inheritance tax is a tax on an heir's right to receive property from a decedent.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 26 ▾ True/False

Question

One of the major reasons for the enactment of the Federal estate tax was to prevent large amounts of wealth from being accumulated within the family unit.

Answer True
 False

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 27 ▾ True/False

Question

Under Clint's will, all of his property passes to either the Lutheran Church or to his wife. No Federal estate tax will be due on Clint's death in 2012.

Answer True
 False

Correct Feedback A combination of the charitable and marital deductions will eliminate Clint's taxable estate.

Incorrect Feedback A combination of the charitable and marital deductions will eliminate Clint's taxable estate.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 28 ▾ True/False

Question

Under a state inheritance tax, two heirs, a cousin and a son of the deceased, would be taxed at the same rate.

Answer True
 False

Correct Feedback The more closely related the heir is to the decedent, the larger the exemption allowed and/or the lower the tax rate imposed.

Incorrect Feedback The more closely related the heir is to the decedent, the larger the exemption allowed and/or the lower the tax rate imposed.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 29 ▾ True/False

Question

The annual exclusion, currently \$13,000, is available for gift but not estate tax purposes.

Answer True
 False

Correct Feedback The annual exclusion is not available for estate tax purposes.

Incorrect Feedback The annual exclusion is not available for estate tax purposes.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 30 ▾ True/False

Question

In 2012, José, a widower, sells land (fair market value of \$100,000) to his daughter, Linda, for \$50,000. José has made a taxable gift of \$50,000.

Answer True
 False

Correct Feedback $\$100,000$ (value of land) – $\$50,000$ (consideration received) – $\$13,000$ (per donee annual exclusion) = $\$37,000$ (taxable gift).

Incorrect Feedback $\$100,000$ (value of land) – $\$50,000$ (consideration received) – $\$13,000$ (per donee annual exclusion) = $\$37,000$ (taxable gift).

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 31 ▾ True/False

Question

Julius, a married taxpayer, makes gifts to each of his six children. A maximum of twelve annual exclusions could be allowed as to these gifts.

Answer True
 False

Correct Feedback If Julius can obtain the consent of his wife to make the election to split the gifts, twelve per donee annual exclusions are available.

Incorrect Feedback If Julius can obtain the consent of his wife to make the election to split the gifts, twelve per donee annual exclusions are available.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 32 ▾ True/False

Question

One of the motivations for making a gift is to save on income taxes.

Answer

True
 False

Correct Feedback This presumes that income-producing property is involved and that the donee is in a lower tax bracket than the donor.

Incorrect Feedback This presumes that income-producing property is involved and that the donee is in a lower tax bracket than the donor.

[◀ Add Question Here](#)

Question 33 ▾

True/False

[Modify](#)

[Remove](#)

Question

The formula for the Federal income tax on corporations is the same as that applicable to individuals.

Answer

True
 False

Correct Feedback For example, an AGI determination is required only for individual taxpayers.

Incorrect Feedback For example, an AGI determination is required only for individual taxpayers.

[◀ Add Question Here](#)

Question 34 ▾

True/False

[Modify](#)

[Remove](#)

Question

A state income tax *can* be imposed on *nonresident* taxpayers who earn income within the state or on an itinerant basis.

Answer

True
 False

Correct Feedback Highly-paid taxpayers (e.g., entertainers, athletes) are often subject to a state's income tax. The so-called "jock tax" has been criticized since it singles out highly-paid and well known personalities and is not imposed on the average business traveler.

Incorrect Feedback Highly-paid taxpayers (e.g., entertainers, athletes) are often subject to a state's income tax. The so-called "jock tax" has been criticized since it singles out highly-paid and well known personalities and is not imposed on the average business traveler.

[◀ Add Question Here](#)

Question 35 ▾

True/False

[Modify](#)

[Remove](#)

Question

For state income tax purposes, a majority of states allow a deduction for Federal income taxes.

Answer

True
 False

Correct Feedback Only a minority allow the deduction.

Incorrect Feedback Only a minority allow the deduction.

[◀ Add Question Here](#)

Question 36 ▾

True/False

[Modify](#)

[Remove](#)

Question

Some states use their state income tax return as a means of collecting unpaid sales and use taxes.

Answer

True
 False

Correct Feedback Often a table is provided that suggests an amount to be used.

Incorrect Feedback Often a table is provided that suggests an amount to be used.

[◀ Add Question Here](#)

Question 37 ▾

True/False

[Modify](#)

[Remove](#)

Question

No state has offered an income tax amnesty program more than once.

Answer

True
 False

Correct Feedback One state has had at least four.

Incorrect Feedback One state has had at least four.

[◀ Add Question Here](#)

Question 38 ▾

True/False

[Modify](#)

[Remove](#)

Question

For Federal income tax purposes, there never has been a general amnesty period.

Answer

True
 False

Correct Feedback Limited amnesty has been made available as to various tax penalties in certain tax shelter situations.

Incorrect Feedback Limited amnesty has been made available as to various tax penalties in certain tax shelter situations.

[◀ Add Question Here](#)

Question 39 ▾

True/False

[Modify](#)

[Remove](#)

Question

Under state amnesty programs, all delinquent and unpaid income taxes are forgiven.

Answer

True
 False

Correct Feedback The taxes and interest are not forgiven. Only the penalties are forgiven.

Incorrect Feedback The taxes and interest are not forgiven. Only the penalties are forgiven.

[◀ Add Question Here](#)

Question 40 ▾

True/False

[Modify](#)

[Remove](#)

Question

When a state decouples from a Federal tax provision, it means that this provision will *not* apply for state income tax purposes.

Answer

True
 False

Correct Feedback In view of tight state finances, decoupling from various Federal tax cuts has become quite common.

Incorrect Feedback In view of tight state finances, decoupling from various Federal tax cuts has become quite common.

[◀ Add Question Here](#)

Question 41 ▾ **True/False**

[Modify](#) [Remove](#)

Question

The principal objective of the FUTA tax is to provide some measure of retirement security.

Answer

True
 False

Correct Feedback This is the objective of the FICA tax.

Incorrect Feedback This is the objective of the FICA tax.

[◀ Add Question Here](#)

Question 42 ▾ **True/False**

[Modify](#) [Remove](#)

Question

Currently, the tax base for the Medicare component of the FICA is *not* limited to a dollar amount.

Answer

True
 False

Correct Feedback There is a dollar amount limitation on the Social Security component of FICA.

Incorrect Feedback There is a dollar amount limitation on the Social Security component of FICA.

[◀ Add Question Here](#)

Question 43 ▾ **True/False**

[Modify](#) [Remove](#)

Question

A parent employs his twin daughters, age 18, in his sole proprietorship. The daughters are *not* subject to FICA coverage.

Answer

True
 False

Correct Feedback The exemption is for taxpayer's children who are *under age 18*.

Incorrect Feedback The exemption is for taxpayer's children who are *under age 18*.

[◀ Add Question Here](#)

Question 44 ▾ **True/False**

[Modify](#) [Remove](#)

Question

Unlike FICA, FUTA requires that employers comply with state as well as Federal rules.

Answer

True
 False

Correct Feedback This is a major difference between FICA and FUTA.

Incorrect Feedback This is a major difference between FICA and FUTA.

[◀ Add Question Here](#)

Question 45 ▾ **True/False**

[Modify](#) [Remove](#)

Question

A major disadvantage of a flat tax type of income tax is its complexity.

Answer

True
 False

Correct Feedback Just the opposite is the case.

Incorrect Feedback Just the opposite is the case.

[◀ Add Question Here](#)

Question 46 ▾ **True/False**

[Modify](#) [Remove](#)

Question

The value added tax (VAT) has had wide acceptance in the international community.

Answer

True
 False

Correct Feedback Its use in 100 countries seems to represent "wide acceptance."

Incorrect Feedback Its use in 100 countries seems to represent "wide acceptance."

[◀ Add Question Here](#)

Question 47 ▾ **True/False**

[Modify](#) [Remove](#)

Question

If more IRS audits are producing a greater number of *no change* results, this indicates increased compliance on the part of taxpayers.

Answer

True
 False

Correct Feedback It indicates that the IRS is not always choosing the right returns to audit (i.e., those that contain errors).

Incorrect Feedback It indicates that the IRS is not always choosing the right returns to audit (i.e., those that contain errors).

[◀ Add Question Here](#)

Question 48 ▾ **True/False**

[Modify](#) [Remove](#)

Question

The amount of a taxpayer's itemized deductions *will* increase the chance of being audited by the IRS.

Answer

True
 False

Correct Feedback If the taxpayer has itemized deductions that are unusually large, the chances of being selected for audit increase.

Incorrect Feedback If the taxpayer has itemized deductions that are unusually large, the chances of being selected for audit increase.

[◀ Add Question Here](#)

Question 49 ▾

True/False

[Modify](#)

[Remove](#)

Question

In an office audit, the audit by the IRS takes place at the office of the IRS.

Answer

✓ True

False

Correct Feedback What is described is an office audit. A field audit takes place at the office of the taxpayer.

Incorrect Feedback What is described is an office audit. A field audit takes place at the office of the taxpayer.

[◀ Add Question Here](#)

Question 50 ▾

True/False

[Modify](#)

[Remove](#)

Question

The IRS agent auditing the return *will not* issue an RAR if the taxpayer owes no additional taxes.

Answer

True

✓ False

Correct Feedback An RAR can result in no change, a deficiency, or a refund.

Incorrect Feedback An RAR can result in no change, a deficiency, or a refund.

[◀ Add Question Here](#)

Question 51 ▾

True/False

[Modify](#)

[Remove](#)

Question

If a "special agent" becomes involved in the audit of a return, this indicates that the IRS suspects that fraud is involved.

Answer

✓ True

False

[◀ Add Question Here](#)

Question 52 ▾

True/False

[Modify](#)

[Remove](#)

Question

If a taxpayer files early (i.e., before the due date of the return), the statute of limitations on assessments begins on the date the return is due.

Answer

✓ True

False

Correct Feedback If begins on the due date of the return.

Incorrect Feedback If begins on the due date of the return.

[◀ Add Question Here](#)

Question 53 ▾

True/False

[Modify](#)

[Remove](#)

Question

For omissions from gross income in excess of 25% of that reported, there is no statute of limitations on additional income tax assessments by the IRS.

Answer

True

✓ False

Correct Feedback Unless fraud is involved, the statute of limitations in this case is six years.

Incorrect Feedback Unless fraud is involved, the statute of limitations in this case is six years.

[◀ Add Question Here](#)

Question 54 ▾

True/False

[Modify](#)

[Remove](#)

Question

If an income tax return is *not* filed by a taxpayer, there is no statute of limitations on assessments of tax by the IRS.

Answer

✓ True

False

[◀ Add Question Here](#)

Question 55 ▾

True/False

[Modify](#)

[Remove](#)

Question

If fraud is involved, there is no time limit on the assessment of a deficiency by the IRS.

Answer

✓ True

False

[◀ Add Question Here](#)

Question 56 ▾

True/False

[Modify](#)

[Remove](#)

Question

The IRS is required to redetermine the interest rate on underpayments and overpayments once a year.

Answer

True

✓ False

Correct Feedback Interest rates are determined quarterly by the IRS.

Incorrect Feedback Interest rates are determined quarterly by the IRS.

[◀ Add Question Here](#)

Question 57 ▾

True/False

[Modify](#)

[Remove](#)

Question

A calendar year taxpayer files his 2011 Federal income tax return on March 5, 2012. The return reflects an overpayment of \$6,000, and the taxpayer requests a refund of this amount. The refund is paid on May 18, 2012. The refund need not include interest.

Answer

✓ True

False

Correct FeedbackSince 45 days have not gone by since the *due date* of the return, interest need not be paid on the refund.**Incorrect Feedback**Since 45 days have not gone by since the *due date* of the return, interest need not be paid on the refund.[◀ Add Question Here](#)

Question 58 ▾

True/False

[Modify](#)[Remove](#)**Question**For individual taxpayers, the interest rate for income tax refunds (overpayments) *is not* the same as that applicable to assessments (underpayments).**Answer**

True

✔ False

Correct FeedbackThere exists no difference in the applicable interest rates for *individual* taxpayers.**Incorrect Feedback**There exists no difference in the applicable interest rates for *individual* taxpayers.[◀ Add Question Here](#)

Question 59 ▾

True/False

[Modify](#)[Remove](#)**Question**

During any month in which both the failure to file penalty and the failure to pay penalty apply, the failure to file penalty is reduced by the amount of the failure to pay penalty.

Answer

✔ True

False

Correct Feedback

The failure to file penalty is reduced by the amount of the failure to pay penalty.

Incorrect Feedback

The failure to file penalty is reduced by the amount of the failure to pay penalty.

[◀ Add Question Here](#)

Question 60 ▾

True/False

[Modify](#)[Remove](#)**Question**

When interest is charged on a deficiency, any part of a month counts as a full month.

Answer

True

✔ False

Correct Feedback

Interest accrues daily.

Incorrect Feedback

Interest accrues daily.

[◀ Add Question Here](#)

Question 61 ▾

True/False

[Modify](#)[Remove](#)**Question**

For the negligence penalty to apply, the underpayment must be caused by intentional disregard of rules and regulations without intent to defraud.

Answer

✔ True

False

Correct Feedback

In the negligence penalty situation, there is no intent to defraud requirement.

Incorrect Feedback

In the negligence penalty situation, there is no intent to defraud requirement.

[◀ Add Question Here](#)

Question 62 ▾

True/False

[Modify](#)[Remove](#)**Question**

Upon audit by the IRS, Faith is assessed a deficiency of \$40,000 of which \$25,000 is attributable to negligence. The 20% negligence penalty will apply to \$40,000.

Answer

True

✔ False

Correct Feedback

The negligence penalty applies only to \$25,000.

Incorrect Feedback

The negligence penalty applies only to \$25,000.

[◀ Add Question Here](#)

Question 63 ▾

True/False

[Modify](#)[Remove](#)**Question**

If the tax deficiency is attributable to fraud, the negligence penalty will not be imposed.

Answer

✔ True

False

[◀ Add Question Here](#)

Question 64 ▾

True/False

[Modify](#)[Remove](#)**Question**The *civil* fraud penalty can entail large fines and possible incarceration.**Answer**

True

✔ False

Correct FeedbackWhat is described is *criminal* fraud. Civil fraud involves a monetary penalty of 75% of the deficiency attributable to fraud.**Incorrect Feedback**What is described is *criminal* fraud. Civil fraud involves a monetary penalty of 75% of the deficiency attributable to fraud.[◀ Add Question Here](#)

Question 65 ▾

True/False

[Modify](#)[Remove](#)**Question**

Even though a client refuses to correct an error on a past return, it may be possible for a practitioner to continue to prepare returns for the client.

Answer

✔ True

False

Correct Feedback However, if the error is material and carries over to the current year, the preparer should consider withdrawing from the engagement.

Incorrect Feedback However, if the error is material and carries over to the current year, the preparer should consider withdrawing from the engagement.

[◀ Add Question Here](#)

Question 66 ▾

True/False

[Modify](#)

[Remove](#)

Question

In preparing an income tax return, the use of a client's estimates is *not* permitted.

Answer

True

✓ False

Correct Feedback Estimates are allowed if reasonable and not given the appearance of greater accuracy than is the case.

Incorrect Feedback Estimates are allowed if reasonable and not given the appearance of greater accuracy than is the case.

[◀ Add Question Here](#)

Question 67 ▾

True/False

[Modify](#)

[Remove](#)

Question

In preparing a tax return, all questions on the return must be answered.

Answer

True

✓ False

Correct Feedback The question need not be answered if the information requested is not readily available, the answer is voluminous, or the question's meaning is uncertain.

Incorrect Feedback The question need not be answered if the information requested is not readily available, the answer is voluminous, or the question's meaning is uncertain.

[◀ Add Question Here](#)

Question 68 ▾

True/False

[Modify](#)

[Remove](#)

Question

A CPA firm in California sends many of its less complex tax returns to be prepared by a group of accountants in India. If certain procedures are followed, this outsourcing of tax return preparation is proper.

Answer

✓ True

False

Correct Feedback Confidentiality must be secured; accuracy verified; and clients advised of the procedure.

Incorrect Feedback Confidentiality must be secured; accuracy verified; and clients advised of the procedure.

[◀ Add Question Here](#)

Question 69 ▾

True/False

[Modify](#)

[Remove](#)

Question

The objective of *pay-as-you-go* (*paygo*) is to achieve revenue neutrality.

Answer

✓ True

False

[◀ Add Question Here](#)

Question 70 ▾

True/False

[Modify](#)

[Remove](#)

Question

When Congress enacts a tax cut that is phased in over a period of years, revenue neutrality is achieved.

Answer

True

✓ False

Correct Feedback No tax cut is revenue neutral unless accompanied by a revenue offset. A phase-in merely postpones some of the revenue loss caused by the tax cut.

Incorrect Feedback No tax cut is revenue neutral unless accompanied by a revenue offset. A phase-in merely postpones some of the revenue loss caused by the tax cut.

[◀ Add Question Here](#)

Question 71 ▾

True/False

[Modify](#)

[Remove](#)

Question

A tax cut enacted by Congress that contains a *sunset provision* will make the tax cut temporary.

Answer

✓ True

False

Correct Feedback The sunset provision rescinds the change and reinstates former law.

Incorrect Feedback The sunset provision rescinds the change and reinstates former law.

[◀ Add Question Here](#)

Question 72 ▾

True/False

[Modify](#)

[Remove](#)

Question

The tax law provides various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain additional education. These provisions can be justified on both economic and social grounds.

Answer

✓ True

False

Correct Feedback The justification is social and economic.

Incorrect Feedback The justification is social and economic.

[◀ Add Question Here](#)

Question 73 ▾

True/False

[Modify](#)

[Remove](#)

Question

Various tax provisions encourage the creation of certain types of retirement plans. Such provisions can be justified on both economic and equity grounds.

Answer

True

✔ False

Correct Feedback

Economic and *social* grounds. The economic justification is attributable to the savings that result. In terms of social justification, private retirement plans supplement the meager benefits provided by Social Security and, thereby, circumvent the need for public assistance.

Incorrect Feedback

Economic and *social* grounds. The economic justification is attributable to the savings that result. In terms of social justification, private retirement plans supplement the meager benefits provided by Social Security and, thereby, circumvent the need for public assistance.

◀ [Add Question Here](#)

Question 74 ▾

True/False

[Modify](#)

[Remove](#)

Question

To lessen, or eliminate, the effect of multiple taxation, a taxpayer who is subject to both foreign and U.S. income taxes on the same income is allowed either a deduction or a credit for the foreign tax paid.

Answer

✔ True
False

◀ [Add Question Here](#)

Question 75 ▾

True/False

[Modify](#)

[Remove](#)

Question

To mitigate the effect of the annual accounting period concept, the tax law permits the carryforward to other years of the excess capital losses of a particular year.

Answer

✔ True
False

Correct Feedback

This is also the case with excess charitable contributions.

Incorrect Feedback

This is also the case with excess charitable contributions.

◀ [Add Question Here](#)

Question 76 ▾

True/False

[Modify](#)

[Remove](#)

Question

Jason's business warehouse is destroyed by fire. As the insurance proceeds exceed the basis of the property, a gain results. If Jason shortly reinvests the proceeds in a new warehouse, no gain is recognized due to the application of the wherewithal to pay concept.

Answer

✔ True
False

◀ [Add Question Here](#)

Question 77 ▾

True/False

[Modify](#)

[Remove](#)

Question

As it is consistent with the wherewithal to pay concept, the tax law requires a seller to recognize gain in the years the proceeds from the installment sale are collected.

Answer

✔ True
False

Correct Feedback

The seller is taxed in the years the installment payments are received.

Incorrect Feedback

The seller is taxed in the years the installment payments are received.

◀ [Add Question Here](#)

Question 78 ▾

True/False

[Modify](#)

[Remove](#)

Question

Stealth taxes have the effect of generating additional taxes from all taxpayers.

Answer

True
✔ False

Correct Feedback Stealth taxes phase out (or eliminate) certain tax benefits from *higher income* taxpayers.

Incorrect Feedback Stealth taxes phase out (or eliminate) certain tax benefits from *higher income* taxpayers.

◀ [Add Question Here](#)

Question 79 ▾

True/False

[Modify](#)

[Remove](#)

Question

A provision in the law that compels accrual basis taxpayers to pay a tax on prepaid income in the year received and *not* when earned is inconsistent with generally accepted accounting principles.

Answer

✔ True
False

Correct Feedback

It is inconsistent with accounting rules, although it can be justified for tax purposes under the wherewithal to pay concept.

Incorrect Feedback

It is inconsistent with accounting rules, although it can be justified for tax purposes under the wherewithal to pay concept.

◀ [Add Question Here](#)

Question 80 ▾

True/False

[Modify](#)

[Remove](#)

Question

As a matter of administrative convenience, the IRS would prefer to have Congress increase (rather than decrease) the amount of the standard deduction allowed to individual taxpayers.

Answer

✔ True
False

◀ [Add Question Here](#)

Question 81 ▾

True/False

[Modify](#)

[Remove](#)

Question

In cases of doubt, courts have held that tax relief provisions should be narrowly construed in favor of taxpayers.

Answer

True
✔ False

Correct Feedback Such provisions should be *narrowly* construed *against* taxpayers.
Incorrect Feedback Such provisions should be *narrowly* construed *against* taxpayers.

[◀ Add Question Here](#)

Question 82 **True/False**

[Modify](#) [Remove](#)

Question

On occasion, Congress has to enact legislation that clarifies the tax law in order to change a result reached by the U.S. Supreme Court.

Answer

✓ True
False

[◀ Add Question Here](#)

Question 83 **Multiple Choice**

[Modify](#) [Remove](#)

Question

Which, if any, of the following statements best describes the history of the Federal income tax?

Answer ✓

It existed during the Civil War.

The Federal income tax on corporations was held by the U.S. Supreme Court to be contrary to the U.S. Constitution.

The Federal income tax on individuals was held by the U.S. Supreme Court to be allowable under the U.S. Constitution.

Both the Federal income tax on individuals and on corporations was held by the U.S. Supreme Court to be contrary to the U.S. Constitution.

None of the above.

[◀ Add Question Here](#)

Question 84 **Multiple Choice**

[Modify](#) [Remove](#)

Question

Which, if any, is *not* one of Adam Smith's canons of taxation?

Answer

Economy.

Certainty.

Convenience.

✓ Simplicity.

Equality.

[◀ Add Question Here](#)

Question 85 **Multiple Choice**

[Modify](#) [Remove](#)

Question

Which, if any, of the following taxes are *proportional* (rather than *progressive*)?

Answer

Federal corporate income tax.

✓ Federal employment taxes (i.e., FICA, FUTA).

Federal estate tax.

Federal gift tax.

All of the above.

Correct Feedback Federal employment taxes are applied at a constant rate that does not progress.

Incorrect Feedback Federal employment taxes are applied at a constant rate that does not progress.

[◀ Add Question Here](#)

Question 86 **Multiple Choice**

[Modify](#) [Remove](#)

Question

Which, if any, of the following transactions will *increase* a taxing jurisdiction's revenue from the *ad valorem* tax imposed on real estate?

Answer

A resident dies and leaves his farm to his church.

A large property owner issues a conservation easement as to some of her land.

✓ A tax holiday issued 10 years ago has expired.

A bankrupt motel is acquired by the Red Cross and is to be used to provide housing for homeless persons.

None of the above.

Correct Feedback Although a farm was probably subject to reduced valuation (due to its agricultural use), it will now be fully exempt since it is owned by a church (choice a.). Property that is subject to a conservation easement is usually appraised at a lower value (choice b.). The expiration of a tax holiday means that the property involved can now be taxed (choice c.). The motel has been converted from business property to exempt charitable use (choice d.).

Incorrect Feedback Although a farm was probably subject to reduced valuation (due to its agricultural use), it will now be fully exempt since it is owned by a church (choice a.). Property that is subject to a conservation easement is usually appraised at a lower value (choice b.). The expiration of a tax holiday means that the property involved can now be taxed (choice c.). The motel has been converted from business property to exempt charitable use (choice d.).

[◀ Add Question Here](#)

Question 87 **Multiple Choice**

[Modify](#) [Remove](#)

Question

Which, if any, of the following transactions will *decrease* a taxing jurisdiction's *ad valorem* tax revenue imposed on real estate?

Answer

A tax holiday is granted to an out-of-state business that is searching for a new factory site.

An abandoned church is converted to a restaurant.

A public school is razed and turned into a city park.

A local university sells a dormitory for use as an apartment building.

None of the above.

Correct Feedback

Choice a. has an effect since the tax holiday was granted. Choice b. will increase taxes as the church was abandoned and previously exempt. Choice c. converts one tax-exempt property (i.e., school) into another (i.e., public park). Choice d. probably places the building on the tax rolls because it is no longer owned by a tax-exempt institution.

Incorrect Feedback

Choice a. has an effect since the tax holiday was granted. Choice b. will increase taxes as the church was abandoned and previously exempt. Choice c. converts one tax-exempt property (i.e., school) into another (i.e., public park). Choice d. probably places the building on the tax rolls because it is no longer owned by a tax-exempt institution.

[◀ Add Question Here](#)

Question 88 ▾

Multiple Choice

[Modify](#)

[Remove](#)

Question

Which, if any, of the following is a typical characteristic of an *ad valorem* tax on personalty?

Answer

Taxpayer compliance is greater for personal use property than for business use property.



The tax on automobiles sometimes considers the age of the vehicle.

Most states impose a tax on intangibles.

The tax on intangibles generates considerable revenue since it is difficult for taxpayers to avoid.

None of the above.

Correct Feedback

Taxpayer compliance is greater with business use property (choice a.). Very few states impose a tax on intangibles (choice c.) because it is easily avoided and does not generate much revenue (choice d.).

Incorrect Feedback

Taxpayer compliance is greater with business use property (choice a.). Very few states impose a tax on intangibles (choice c.) because it is easily avoided and does not generate much revenue (choice d.).

[◀ Add Question Here](#)

Question 89 ▾

Multiple Choice

[Modify](#)

[Remove](#)

Question

Federal excise taxes that are *no longer imposed* include:

Answer

Tax on air travel.

Tax on wagering.

Tax on the manufacture of sporting equipment.



Tax on theatre admissions.

None of the above.

[◀ Add Question Here](#)

Question 90 ▾

Multiple Choice

[Modify](#)

[Remove](#)

Question

Taxes *not imposed* by the Federal government include:

Answer

Tobacco excise tax.



Hotel occupancy tax.

Customs duties (tariffs on imports).

Gas guzzler tax.

None of the above.

Correct Feedback

The Federal government imposes an excise tax on tobacco (choice a.), customs duties (choice c.), and a gas guzzler tax (choice d.). It does not impose a tax on hotel occupancy (choice b.).

Incorrect Feedback

The Federal government imposes an excise tax on tobacco (choice a.), customs duties (choice c.), and a gas guzzler tax (choice d.). It does not impose a tax on hotel occupancy (choice b.).

[◀ Add Question Here](#)

Question 91 ▾

Multiple Choice

[Modify](#)

[Remove](#)

Question

Taxes levied by *both* states and the Federal government include:

Answer

General sales tax.

Custom duties.

Car rental tax.

Franchise tax.



None of the above.

Correct Feedback Choices a., c., and d. are levied at the state or local level. Choice b. is strictly a Federal levy.

Incorrect Feedback Choices a., c., and d. are levied at the state or local level. Choice b. is strictly a Federal levy.

[◀ Add Question Here](#)

Question 92 ▼ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Taxes levied by *all* states include:

Answer

- Tobacco excise tax.
- Individual income tax.
- Inheritance tax.
- General sales tax.
- None of the above.

Correct Feedback

All states impose a tobacco excise tax (choice a.). Most states impose individual income taxes (choice b.) and general sales taxes (choice d.), and only some states impose inheritance taxes (choice c.).

Incorrect Feedback

All states impose a tobacco excise tax (choice a.). Most states impose individual income taxes (choice b.) and general sales taxes (choice d.), and only some states impose inheritance taxes (choice c.).

[◀ Add Question Here](#)

Question 93 ▼ **Multiple Choice**

[Modify](#) [Remove](#)

Question

A use tax is imposed by:

Answer

- The Federal government and all states.
- The Federal government and a majority of the states.
- All states and not the Federal government.
- Most of the states and not the Federal government.
- None of the above.

Correct Feedback

A use tax is a complement to a general sales tax. Consequently, it is imposed by most states because only a few states do not have a general sales tax. At this point, the Federal government has no general sales tax.

Incorrect Feedback

A use tax is a complement to a general sales tax. Consequently, it is imposed by most states because only a few states do not have a general sales tax. At this point, the Federal government has no general sales tax.

[◀ Add Question Here](#)

Question 94 ▼ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Burt and Lisa are married and live in a common law state. Burt wants to make gifts to their five children in 2012. What is the maximum amount of the annual exclusion they will be allowed for these gifts?

Answer

- \$130,000.
- \$65,000.
- \$26,000.
- \$13,000.
- None of the above.

Correct Feedback 5 (number of donees) \times \$13,000 (annual exclusion) \times 2 (number of donors) = \$130,000. It is assumed that Lisa will make the election to split the gifts.

Incorrect Feedback

5 (number of donees) \times \$13,000 (annual exclusion) \times 2 (number of donors) = \$130,000. It is assumed that Lisa will make the election to split the gifts.

[◀ Add Question Here](#)

Question 95 ▼ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Property can be transferred within the family group by gift or at death. One motivation for preferring the gift approach is:

Answer

- To take advantage of the higher unified transfer tax credit available under the gift tax.
- To avoid a future decline in value of the property transferred.
- To take advantage of the per donee annual exclusion.
- To shift income to higher bracket donees.
- None of the above.

Correct Feedback

The per donee annual exclusion is only available for gift tax purposes (choice c.). Ideally, gifts should involve property that is expected to *appreciate* in value (choice b.). A higher unified tax credit is not available for gift tax purposes (choice a.). Usually the donor is trying to shift future income to *lower* bracket donees (choice d.).

Incorrect Feedback

The per donee annual exclusion is only available for gift tax purposes (choice c.). Ideally, gifts should involve property that is expected to *appreciate* in value (choice b.). A higher unified tax credit is not available for gift tax purposes (choice a.). Usually the donor is trying to shift future income to *lower* bracket donees (choice d.).

[◀ Add Question Here](#)

Multiple Choice

[Modify](#) [Remove](#)

Question 96 ▾

QuestionIndicate which, if any, statement is *incorrect*. State income taxes:**Answer**

- Can piggyback to the Federal version.
- Cannot apply to visiting nonresidents.
- Can decouple from the Federal version.
- Can provide occasional amnesty programs.
- None of the above.

Correct Feedback

Many states piggyback to the Federal system (choice a.). Some states, due to revenue shortfalls, have decoupled from various provisions of the Federal version (choice c.). The "jock tax," although much criticized, is very much in being (choice b.). Some states have had more than one amnesty period (choice d.).

Incorrect Feedback

Many states piggyback to the Federal system (choice a.). Some states, due to revenue shortfalls, have decoupled from various provisions of the Federal version (choice c.). The "jock tax," although much criticized, is very much in being (choice b.). Some states have had more than one amnesty period (choice d.).

[◀ Add Question Here](#)[Modify](#)[Remove](#)

Question 97 ▾

Multiple Choice**Question**State income taxes *generally* can be characterized by:**Answer**

- A different date for filing than the Federal income tax.
- No provision for withholding procedures.
- Allowance of a deduction for Federal income taxes paid.
- Applying only to individuals and not applying to corporations.
- None of the above.

[◀ Add Question Here](#)[Modify](#)[Remove](#)

Question 98 ▾

Multiple Choice**Question**

A characteristic of FICA is that:

Answer

- It applies when one spouse works for the other spouse.
- It is imposed only on the employer.
- It provides a modest source of income in the event of loss of employment.
- It is administered by both state and Federal governments.
- None of the above.

Correct Feedback

FICA is imposed on *both* the employer and the employee (choice a.). Spouses who work for each other are not exempt from the tax (choice b.). Its objective is retirement income, not loss of employment (choice c.). It is administered only by the Federal government (choice d.).

Incorrect Feedback

FICA is imposed on *both* the employer and the employee (choice a.). Spouses who work for each other are not exempt from the tax (choice b.). Its objective is retirement income, not loss of employment (choice c.). It is administered only by the Federal government (choice d.).

[◀ Add Question Here](#)[Modify](#)[Remove](#)

Question 99 ▾

Multiple Choice**Question**

A characteristic of FUTA is that:

Answer

- It is imposed on both employer and employee.
- It is imposed solely on the employee.
- Compliance requires following guidelines issued by both state and Federal regulatory authorities.
- It is applicable to spouses of employees but *not* to any children under age 18.
- None of the above.

Correct Feedback

FUTA is imposed only on the employer (choices a. and b.). Choice d. refers to FICA. Since the administration of FUTA is shared by Federal and state governments, employers must comply with the rules issued by each (choice c.).

Incorrect Feedback

FUTA is imposed only on the employer (choices a. and b.). Choice d. refers to FICA. Since the administration of FUTA is shared by Federal and state governments, employers must comply with the rules issued by each (choice c.).

[◀ Add Question Here](#)[Modify](#)[Remove](#)

Question 100 ▾

Multiple Choice**Question**The U.S. (either Federal, state, or local) *does not* impose:**Answer**

- Franchise taxes.
- Severance taxes.
- Occupational fees.

- ✓ Export duties.
- Customs duties.

◀ [Add Question Here](#)

Question 101 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

The proposed *flat tax*:

Answer

- Would eliminate the income tax.
- ✓ Would simplify the income tax.
- Would tax the increment in value as goods move through the production and manufacturing stages to the marketplace.
- Is a tax on consumption.
- None of the above.

Correct Feedback

There is only a single rate. The tax base is simplified by taxing only limited types of income. Many deductions and credits would be eliminated.

Incorrect Feedback

There is only a single rate. The tax base is simplified by taxing only limited types of income. Many deductions and credits would be eliminated.

◀ [Add Question Here](#)

Question 102 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

A VAT (value added tax):

Answer

- ✓ Is regressive in its effect.
- Has not proved popular outside of the U.S.
- Is *not* a tax on consumption.
- Is used exclusively by third world (less developed) countries.
- None of the above.

Correct Feedback

Both the VAT and a general sales tax are taxes on consumption (choice c.) and are regressive in effect (choice a.). The VAT has been adopted by many countries (choice b.), many of which (e.g., Japan, Denmark) *are not* third world countries (choice d.).

Incorrect Feedback

Both the VAT and a general sales tax are taxes on consumption (choice c.) and are regressive in effect (choice a.). The VAT has been adopted by many countries (choice b.), many of which (e.g., Japan, Denmark) *are not* third world countries (choice d.).

◀ [Add Question Here](#)

Question 103 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Characteristics of the "Fair Tax" (i.e., national sales tax) include which, if any, of the following:

Answer

- Abolition of the Federal individual (but not the corporate) income tax.
- Abolition of all Federal income taxes but retention of payroll taxes (including the self-employment tax).
- Abolition of all Federal income taxes and payroll taxes but retention of the Federal estate and gift taxes.
- ✓ Abolition of all Federal income and payroll taxes as well as the Federal estate and gift taxes.
- None of the above.

◀ [Add Question Here](#)

Question 104 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

In terms of probability, which of the following taxpayers would be *least likely* to be audited by the IRS?

Answer

- Taxpayer owns and operates a check-cashing service.
- ✓ Taxpayer is an employed electrician.
- Taxpayer just received a \$3 million personal injury award as a result of a lawsuit.
- Taxpayer just won a \$1 million slot machine jackpot at a Las Vegas casino.
- Taxpayer has been audited several times before.

Correct Feedback

Employees are subject to income tax withholding and have little opportunity to avoid reporting income (choice b.). Casino gambling income is subject to Form 1099 reporting (choice d.).

Incorrect Feedback

Employees are subject to income tax withholding and have little opportunity to avoid reporting income (choice b.). Casino gambling income is subject to Form 1099 reporting (choice d.).

◀ [Add Question Here](#)

Question 105 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Which of the following *is* a characteristic of the audit process?

Answer

Most taxpayer audits involve "special" agents.

Self-employed taxpayers are less likely to be selected for audit than employed taxpayers.



Less important issues are handled by means of a correspondence audit.

If a taxpayer disagrees with the IRS auditor's finding, the only resort is to the courts.

None of the above.

Correct Feedback

Special agents are assigned to an audit only when fraud might be involved (choice a.). Self-employed persons have more flexibility in manipulating income and deductions than do employed taxpayers (choice b.). The next step after an initial audit would be the Appeals Division within the IRS (choice d.). Settlement at this level could avoid costly litigation.

Incorrect Feedback

Special agents are assigned to an audit only when fraud might be involved (choice a.). Self-employed persons have more flexibility in manipulating income and deductions than do employed taxpayers (choice b.). The next step after an initial audit would be the Appeals Division within the IRS (choice d.). Settlement at this level could avoid costly litigation.

[Add Question Here](#)

Question 106

Multiple Choice

[Modify](#)

[Remove](#)

Question

Scott files his tax return 65 days after the due date. Along with the return, Scott remits a check for \$50,000 which is the balance of the tax owed. Disregarding the interest element, Scott's total failure to file and to pay penalties are:

Answer

\$8,250.



\$7,500.

\$6,000.

\$750.

None of the above.

Correct Feedback

Following the procedure set forth in Example 15, the penalty is determined as follows:

Failure to pay penalty [0.5% „ \$50,000 „ 3 (two months violation)]	\$ 750
Plus: Failure to file penalty [5% „ \$50,000 „ 3 (three months violation)]	\$7,500
Less: Failure to pay penalty	<u>(750)</u>
Total penalties	<u>\$7,500</u>

Incorrect Feedback

Following the procedure set forth in Example 15, the penalty is determined as follows:

Failure to pay penalty [0.5% „ \$50,000 „ 3 (two months violation)]	\$ 750
Plus: Failure to file penalty [5% „ \$50,000 „ 3 (three months violation)]	\$7,500
Less: Failure to pay penalty	<u>(750)</u>
Total penalties	<u>\$7,500</u>

[Add Question Here](#)

Question 107

Multiple Choice

[Modify](#)

[Remove](#)

Question

A characteristic of the fraud penalties is:

Answer

When negligence and civil fraud apply to a deficiency, the civil fraud penalty predominates.

Civil fraud can result in a fine and a prison sentence.

The criminal fraud penalty is 75% of the deficiency attributable to the fraud.

The IRS has the same burden of proof in the case of criminal fraud than with civil fraud.

None of the above.

Correct Feedback

Choice b. describes criminal fraud, while choice c. describes civil fraud. When both negligence and civil fraud exists as to the same deficiency, both penalties cannot apply and the civil fraud penalty predominates (choice a.). In the case of criminal fraud, the IRS must also show willfulness on the part of the taxpayer (choice d.).

Incorrect Feedback

Choice b. describes criminal fraud, while choice c. describes civil fraud. When both negligence and civil fraud exists as to the same deficiency, both penalties cannot apply and the civil fraud penalty predominates (choice a.). In the case of criminal fraud, the IRS must also show willfulness on the part of the taxpayer (choice d.).

[Add Question Here](#)

Question 108

Multiple Choice

[Modify](#)

[Remove](#)

Question

Regarding proper ethical guidelines, which (if any) of the following is correct?

Answer

The use of client estimates in preparing a return is *not* acceptable.

Under no circumstances should a question on a tax return be left unanswered.

If a client has made a mistake in a prior year's return and refuses to correct it, you should withdraw from the engagement.

If the exact amount of a deduction is not certain (e.g., around mid-\$600s), it *should* be recorded as an odd amount (i.e., \$649) so as to increase the appearance of greater certainty.



None of the above.

Correct Feedback

In some cases, the use of client estimates is acceptable (choice a.), but they should not give the appearance of certainty (choice d.). Questions can be left blank if their meaning is uncertain or the answer is not readily available or voluminous (choice b.). Withdrawal is not necessary if the error is not material or does not have a carryover effect on the current year return (choice c.).

Incorrect Feedback In some cases, the use of client estimates is acceptable (choice a.), but they should not give the appearance of certainty (choice d.). Questions can be left blank if their meaning is uncertain or the answer is not readily available or voluminous (choice b.). Withdrawal is not necessary if the error is not material or does not have a carryover effect on the current year return (choice c.).

[◀ Add Question Here](#)

Question 109 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Both economic and social considerations can be used to justify:

Answer

Favorable tax treatment for accident and health plans provided for employees and financed by employers.

Disallowance of any deduction for expenditures deemed to be contrary to public policy (e.g., fines, penalties, illegal kickbacks, bribes to government officials).



Various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain additional education.

Allowance of a deduction for state and local income taxes paid.

None of the above.

[◀ Add Question Here](#)

Question 110 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Social considerations can be used to justify:

Answer



Allowance of a credit for child care expenses.

Allowing excess capital losses to be carried over to other years.

Allowing accelerated amortization for the cost of installing pollution control facilities.

Allowing a Federal income tax deduction for state and local sales taxes.

None of the above.

Correct Feedback Equity considerations justify choices b. and d., and economic considerations justify choice c.

Incorrect Feedback Equity considerations justify choices b. and d., and economic considerations justify choice c.

[◀ Add Question Here](#)

Question 111 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Allowing a domestic production activities deduction for certain manufacturing income can be justified:

Answer

As mitigating the effect of the annual accounting period concept.

As promoting administrative feasibility.



By economic considerations.

Based on the wherewithal to pay concept.

None of the above.

Correct Feedback The deduction will encourage U.S. manufacturing. It also will lead to job growth and discourage the outsourcing of labor to overseas.

Incorrect Feedback The deduction will encourage U.S. manufacturing. It also will lead to job growth and discourage the outsourcing of labor to overseas.

[◀ Add Question Here](#)

Question 112 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Provisions in the tax law that promote energy conservation and more use of alternative (non-fossil) fuels can be justified by:

Answer

Political considerations.



Economic and social considerations.

Promoting administrative feasibility.

Encouragement of small business.

None of the above.

Correct Feedback Although it may be “good politics” to promote measures that ease the problem of global warming (choice a.), the real justification is economic (curtail dependence on foreign oil) and social (reduce pollution)—choice b. The encouragement of small business (choice d.) is a byproduct of these conservation provisions, but is not their justification.

Incorrect Feedback Although it may be “good politics” to promote measures that ease the problem of global warming (choice a.), the real justification is economic (curtail dependence on foreign oil) and social (reduce pollution)—choice b. The encouragement of small business (choice d.) is a byproduct of these conservation provisions, but is not their justification.

[◀ Add Question Here](#)

Question 113 ▾ **Multiple Choice**

[Modify](#) [Remove](#)

Question

Which, if any, of the following provisions *cannot* be justified as mitigating the effect of the annual accounting period concept?

Answer



Nonrecognition of gain allowed for involuntary conversions.

Net operating loss carryback and carryover provisions.

Carry over of excess charitable contributions.

Use of the installment method to recognize gain.

Carry over of excess capital losses.

Correct Feedback The involuntary conversion provision is based on the wherewithal to pay concept (choice a.).

Incorrect Feedback The involuntary conversion provision is based on the wherewithal to pay concept (choice a.).

[◀ Add Question Here](#)

Question 114 **Multiple Choice**

[Modify](#)

[Remove](#)

Question

Which, if any, of the following provisions of the tax law *cannot* be justified as promoting administrative feasibility (simplifying the task of the IRS)?

Answer

Penalties are imposed for failure to file a return or pay a tax on time.

Prepaid income is taxed in the year received and not in the year earned.

Annual adjustments for indexation increases the amount of the standard deduction allowed.

Casualty losses must exceed 10% of AGI to be deductible.



A deduction is allowed for charitable contributions.

Correct Feedback

Choices a. through d. aid the IRS in administering the tax laws. Choice e., particularly when trying to value property contributions, will add to the audit effort required by the IRS.

Incorrect Feedback

Choices a. through d. aid the IRS in administering the tax laws. Choice e., particularly when trying to value property contributions, will add to the audit effort required by the IRS.

[◀ Add Question Here](#)

Question 115 **Multiple Choice**

[Modify](#)

[Remove](#)

Question

A landlord leases property upon which the tenant makes improvements. The improvements are significant and are not made in lieu of rent. At the end of the lease, the value of the improvements are not income to the landlord. This rule is an example of:

Answer

A clear reflection of income result.

The tax benefit rule.

The arm's length concept.



The wherewithal to pay concept.

None of the above.

[◀ Add Question Here](#)

Question 116 **Matching**

[Modify](#)

[Remove](#)

Question

Match the statements that relate to each other. Note: Choice k may be used more than once.

Answer Match Question Items

- D. - A.
Jock tax
- F. - B.
Decoupling
- G. - C.
DIF
- E. - D.
Tax fraud suspected
- H. - E.
Revenue neutrality
- C. - F.
RAR
- A. - G.
Wherewithal to pay concept
- B. - H.
Mitigation of the annual accounting period concept
- J. - I.
Tax on transfers at death (inheritance type)
- L. - J.
Excise tax on tobacco
- I. - K.
Use tax
- J. - L.
Income tax amnesty
- G. - M.
Tax deficiency assessed in prior years
- H. - N.
"Pay-as-you-go" (paygo)
- L. - O.
Export taxes

Answer Items

- A.
Deferral of gains from involuntary conversions
- B.
Carryback and carryforward of net operating losses
- C.
"No change" is one possible result
- D.
State income tax applied to visiting nonresident
- E.
IRS special agent
- F.
Undoing the "piggyback" result
- G.
Criteria in the selection of tax returns for audit
- H.
Ideal budget goal as to new tax legislation
- I.
Every state that has a general sales tax has one
- J.
Imposed by some states but not the Federal government
- K.
Imposed only by the Federal government
- L.
No correct match provided

[◀ Add Question Here](#)

Question 117 **Matching**

[Modify](#)

[Remove](#)

Question

Match the statements that relate to each other. Note: Some choices may be used more than once.

Answer Match Question Items

- G. - A.
Office audit
- F. - B.
Field audit
- E. - C.
Failure to file penalty
- D. - D.
Failure to pay penalty
- C. - E.
Negligence penalty
- L. - F.
Criminal fraud penalty
- J. - G.
Fraud and statute of limitations
- A. - H.
Early filing and statute of limitations (deficiency situations)
- B. - I.
Late filing and statute limitations (deficiency situations)
- J. - J.
No return and statute limitations
- H. - K.
More than 25% gross income omission and statute of limitations
- I. - L.
Interest due on refund

Answer Items

- A.
3 years from due date of return
- B.
3 years from date return is filed
- C.
20% of underpayment
- D.
0.5% per month (25% limit)
- E.
5% per month (25% limit)
- F.
Conducted at taxpayer's office
- G.
Conducted at IRS office
- H.
6 years
- I.
45-day grace period allowed to IRS
- J.
No statute of limitations (period remains open)
- K.
75% of underpayment
- L.
No correct match provided

[◀ Add Question Here](#)

Question 118 ▾

Matching

[Modify](#)

[Remove](#)

Question

Using the choices provided below, show the justification for each provision of the tax law listed.

Answer Match Question Items

- B. - A.
A tax credit for amounts spent to furnish care for children while the parent is at work.
- A. - B.
Additional depreciation deduction allowed for the year the asset is acquired.
- C. - C.
Tax brackets are increased for inflation.
- A. - D.
A small business corporation can elect to avoid the corporate income tax.
- A. - E.
A deduction for certain expenses (interest and taxes) incident to home ownership.
- C. - F.
A Federal deduction for state and local income taxes paid.
- A. - G.
A deduction for certain income from manufacturing activities.
- B. - H.
A bribe to the local sheriff, although business related, is not deductible.
- B. - I.
Contributions to charitable organizations are deductible.
- C. - J.
A Federal deduction for state and local sales taxes paid.
- A. - K.
Tax credits available for the purchase of a vehicle that uses alternative (non-fossil) fuels.
- A. - L.
Tax credits for home improvements that conserve energy.
- A. - M.
More rapid expensing for tax purposes of the costs of installing pollution control devices.

Answer Items

- A.
Economic considerations
- B.
Social considerations
- C.
Equity considerations

[◀ Add Question Here](#)

Question 119 ▾

Essay

[Modify](#)

[Remove](#)

Question

Using the choices provided below, show the justification for each provision of the tax law listed. Note: In some cases, more than one answer is appropriate.

- a. Economic considerations
- b. Social considerations
- c. Equity considerations

A deduction for contributions by an employee to certain retirement plans.

Answer a. Economic considerations or b. Social considerations

[◀ Add Question Here](#)

Question 120 ▾

Essay

[Modify](#)

[Remove](#)

Question

Using the choices provided below, show the justification for each provision of the tax law listed. Note: In some cases, more than one answer is appropriate.

- a. Economic considerations
- b. Social considerations
- c. Equity considerations

A deduction for qualified tuition paid to obtain higher education.

Answer a. Economic considerations or b. Social considerations

[◀ Add Question Here](#)

Question 121 ▾

Essay

[Modify](#)

[Remove](#)

Question

Pam, a widow, makes cash gifts to her four married children (including their spouses) and to her six grandchildren.

- What is the maximum amount Pam can give for calendar year 2012 without using her unified transfer tax credit?
- What is the maximum amount Pam can give for calendar year 2012 also using her unified transfer tax credit? [Note: Pam has never made any prior taxable gifts.]

- Answer**
- \$182,000. \$13,000 (annual exclusion) „ 14 donees = \$182,000.
 - \$5,182,000. \$13,000 (annual exclusion) „ 14 donees = \$182,000 + \$5,000,000 (the exemption equivalent of a \$1,730,800 credit) = \$5,182,000.

[◀ Add Question Here](#)

Question 122 ▾ **Essay**

[Modify](#) [Remove](#)

Question

For the tax year 2012, Andrew reported gross income of \$200,000 on his timely filed Federal income tax return.

- Presuming the general rule applies, when does the statute of limitations on assessments normally expire?
- Suppose Andrew inadvertently omitted gross income of \$51,000. When does the statute of limitations on assessments expire?
- Suppose the omission was deliberate and not inadvertent. When does the statute of limitations on assessments expire?

- Answer**
- Three years from April 15, 2013.
 - If more than 25% of gross income is omitted, a six-year statute applies (i.e., 6 years from April 15, 2013). Here, it does as \$51,000 is more than \$50,000 (25% „ \$200,000).
 - If fraud is involved, the statute never expires.

[◀ Add Question Here](#)

Question 123 ▾ **Essay**

[Modify](#) [Remove](#)

Question

Without obtaining an extension, Olivia files her income tax return 65 days after the due date. With her return, she pays an additional tax of \$50,000. Disregarding any interest element, what is Olivia's penalty for failure to pay and to file?

Answer \$7,500. Disregarding the interest element, Olivia's total penalties are as follows:

Failure to pay penalty (0.5% „ \$50,000 „ 3 months)		\$ 750
Plus: Failure to file penalty (5% „ \$50,000 „ 3 months)	\$7,500	
Less failure to pay penalty for same period	(750)	6,750
Total penalties		<u>\$7,500</u>

[◀ Add Question Here](#)

Question 124 ▾ **Essay**

[Modify](#) [Remove](#)

Question

On his 2012 income tax return, Logan omitted income and overstated deductions to the extent that his income tax was understated by \$400,000. Disregarding any interest element, what is Logan's penalty if the understatement was due to:

- Negligence.
- Civil fraud.
- Criminal fraud.

- Answer**
- \$80,000 (20% „ \$400,000).
 - \$300,000 (75% „ \$400,000).
 - Various fines and/or prison sentence.

[◀ Add Question Here](#)

Question 125 ▾ **Essay**

[Modify](#) [Remove](#)

Question

Several years ago, Lucas purchased extra grazing land for his ranch at a cost of \$120,000. In 2012, the land is condemned by the state for development as a highway maintenance depot. Under the condemnation award, Lucas receives \$300,000 for the land. Within the same year, he replaces the property with other grazing land. What is Lucas's tax situation if the replacement land cost:

- \$105,000?
- \$180,000?
- \$315,000?
- Why?

- Answer**
- The full realized gain of \$180,000 [\$300,000 (condemnation proceeds) – \$120,000 (cost of land)] must be recognized, as only \$105,000 was reinvested. The condemnation proceeds of \$300,000 exceed the amount reinvested by more than \$180,000.
 - As only \$180,000 was reinvested in replacement property, \$120,000 (\$300,000 – \$180,000) of the gain must be recognized.
 - As the full \$300,000 was reinvested, no realized gain need be recognized.
 - If some of the gain is not reinvested, consistent with the wherewithal to pay concept there exists the ability to pay the tax.

[◀ Add Question Here](#)

Question 126 ▾ **Essay**

[Modify](#) [Remove](#)

Question

Paige is the sole shareholder of Citron Corporation. During the year, Paige leases a building to Citron for a monthly rental of \$80,000. If the fair rental value of the building is \$60,000, what are the income tax consequences to the parties involved?

Answer The rent charged by Paige is not "arms length"; as such, Citron Corporation's rent deduction is \$60,000 (not \$80,000). The \$20,000 difference is a nondeductible dividend distribution. For Paige, the change merely requires reclassification. Instead of \$80,000 of rent income, she has \$60,000 of rent income and \$20,000 of dividend income.

[◀ Add Question Here](#)

Question 127 ▾ **Essay**

[Modify](#) [Remove](#)

Question

In 1985, Roy leased real estate to Drab Corporation for 20 years. Drab Corporation made significant capital improvements to the property. In 2005, Roy decides not to renew the lease and vacates the property. At that time, the value of the improvements is \$800,000. Roy sells the real estate in 2012 for \$1,200,000 of which \$900,000 is attributable to the improvements. How and when is Roy taxed on the improvements made by Drab Corporation?

Answer Roy is not subject to taxation on the improvements until he disposes of the property (i.e., 2012). After a controversial Supreme Court decision years ago, Congress clarified the tax law to make it more consistent with the wherewithal to pay

concept.

[◀ Add Question Here](#)

Question 128 ▾

Essay

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Question

The Federal income tax is based on a pay-as-you-go system and has become a “mass tax.” Explain this statement.

Answer The pay-as-you-go system is present in the wage and other withholding procedures. In the case of self-employed persons, it is manifested in the required quarterly payments for estimated taxes. The income tax became a mass tax during World War II when its coverage was extended to 74% of the population (from less than 6% in 1939).

[◀ Add Question Here](#)

Question 129 ▾

Essay

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Question

In terms of Adam Smith’s canons of taxation, how does the Federal income tax fare as far as *equality* is concerned?

Answer Equality is present in the Federal income tax system if ability to pay is the key consideration.

[◀ Add Question Here](#)

Question 130 ▾

Essay

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Question

Timothy recently converted a warehouse into apartment lofts, which he is renting to single professionals. In making the conversion, he emphasized improvements that were portable in nature. Thus, the sprinkler system, heating and cooling units, and room dividers are all removable from the building. In terms of *ad valorem* property taxes, what was Timothy trying to accomplish?

Answer When personalty is permanently attached to real estate so that its removal will cause irreparable damage, it becomes a fixture. Consequently, it ceases to be personalty and is now regarded as realty. The classification of an asset is important because different *ad valorem* taxes apply to realty than to personalty. For one thing, the *ad valorem* tax on realty is less easily avoided. Also to be considered is the possibility that the *ad valorem* tax on personalty (even if it cannot be avoided) could be lower than that applicable to realty.

[◀ Add Question Here](#)

Question 131 ▾

Essay

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Question

Due to the population change, the Goose Creek School District has decided to close one of its high schools. Since it has no further need of the property, the school is listed for sale. The two bids it receives are as follows:

United Methodist Church	\$1,700,000
Planet Motors	1,600,000

The United Methodist Church would use the property to establish a sectarian middle school. Planet, a well-known car dealership, would revamp the property and operate it as a branch location.

If you were a member of the School District board, what factors would you consider in evaluating the two bids?

Answer Although the bid from the United Methodist Church is higher, several other factors need to be considered. Does, for example, Goose Creek School district exempt property owned by churches from its *ad valorem* taxes? If so, losing this property from the tax base could prove very costly over the long run. Also, it is probable that income-producing property (such as a car dealership) would be taxed at a higher rate than that owned by a nonprofit organization (a school operated by a church). This assumes, of course, that the school would be taxed at all. The auto dealership also would generate sales tax.

[◀ Add Question Here](#)

Question 132 ▾

Essay

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Question

Morgan inherits her father’s personal residence including all of the furnishings. She plans to add a swimming pool and sauna to the property and rent it as a furnished house. What are some of the *ad valorem* property tax problems Morgan can anticipate?

Answer The real estate taxes probably will increase for several reasons. The capital improvements and the conversion from residential to rental will trigger the increase. Furthermore, the furnishings may generate an *ad valorem* tax on personalty. (Depending on applicable law, furniture might not be subject to tax unless used for business purposes—such as in this case.)

[◀ Add Question Here](#)

Question 133 ▾

Essay

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Question

In 2010, Deborah became 65 years old. In 2011 she added a swimming pool, and in 2012 she converted the residence to rental property and moved into an assisted living facility. Since 2009, Deborah’s *ad valorem* property taxes have decreased once and increased twice. Explain.

Answer The decrease probably came in 2010 when Deborah reached age 65. The increases probably occurred in 2011 when she added the pool and in 2012 when the residence was converted to rental property.

[◀ Add Question Here](#)

Question 134 ▾

Essay

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Question

A lack of compliance in the payment of use taxes can be resolved by several means. In this regard, comment on the following:

- Registration of automobiles.
- Reporting of Internet purchases on state income tax returns.

Answer a. As reflected in Example 5 in the text, re-registration of a car purchased out-of-state is the occasion for the owner’s home state to collect the use tax.
b. Completing the state income tax return reminds (or forces) the taxpayer to pay use tax on out-of-state-purchases.

[◀ Add Question Here](#)

Question 135 ▾

Essay

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Question

What are the pros and cons of the following state and local tax provisions?

- An *ad valorem* property tax holiday made available to a manufacturing plant that is relocating.
- Hotel occupancy tax and a rental car surcharge.
- A back-to-school sales tax holiday.

Answer a. Such a holiday is designed to attract new industry to the area. This means more jobs and growth in consumption. On the other hand, if the tax holiday is too generous, this places a strain on available public revenue. The result could be that schools and capital maintenance (roads, public services) will suffer.

- b. The hotel occupancy tax and car rental surcharges are popular because they mainly impact visitors. Also, they can generate considerable revenue to finance major capital improvements. If these taxes become excessive, however, they could discourage major events (such as conventions).
- c. Such holidays are very popular with both merchants and consumers and serve the social need of defraying some of the costs of sending children to school. Once established, however, they are difficult to get rid of. Thus, they become an annual drain on sales tax revenue.

[◀ Add Question Here](#)

Question 136 ▾ **Essay**

[Modify](#) [Remove](#)

Question

Ava, an estate planner, is advising her wealthier clients to make any large gifts to family members before 2013. Why?

Answer Under existing law, the exemption equivalent for gift tax purposes is scheduled to decrease from \$5.12 million to \$1 million after 2012. Thus, an extra \$4.12 million in value can be transferred without any tax if the gifts occur before 2013.

[◀ Add Question Here](#)

Question 137 ▾ **Essay**

[Modify](#) [Remove](#)

Question

Noah dies in 2012 with an estate worth \$12 million. Under his will, \$6 million passes to his wife while \$6 million goes to his church. What is Noah's Federal estate tax result?

Answer None. After a marital deduction of \$6 million and a charitable deduction of \$6 million, Noah's taxable estate is \$0.

[◀ Add Question Here](#)

Question 138 ▾ **Essay**

[Modify](#) [Remove](#)

Question

With regard to state income taxes, explain what is meant by the "jock tax"?

Answer Although states have a right to levy an income tax on all nonresidents who earn income within the state, they usually do so only on highly paid visitors. Such persons are often athletes, hence the designation of "jock tax."

[◀ Add Question Here](#)

Question 139 ▾ **Essay**

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Question

Virtually all state income tax returns contain checkoff boxes for donations to various causes. On what grounds has this procedure been criticized?

Answer In many cases the procedure is overused (i.e., a multiplicity of boxes). This overuse adds complexity to the return. Also, in most cases the donation is being drawn from any income tax refund that might be due. Thus, taxpayers may not fully appreciate that they are paying for such checkoffs.

[◀ Add Question Here](#)

Question 140 ▾ **Essay**

[Modify](#) [Remove](#)

Question

State and local governments are sometimes forced to find ways to generate additional revenue. Comment on the pros and cons of the following procedures:

- a. Decouple what would be part of the piggyback format of the state income tax.
- b. Tax amnesty provisions.
- c. Internet shaming.

Answer

- a. The decoupling process is easily accomplished as to new Federal tax changes that have never taken effect at the state level. Taxpayers are not apt to miss what they never have enjoyed.
- b. Tax amnesty provisions generate considerable revenue. It also unmask many taxpayers who have not previously paid taxes. Now that the taxing jurisdiction is aware of their existence, they will tend to pay taxes in the future.
- c. By use of a public Web site, the taxing authority posts the names of those taxpayers that are delinquent as to various taxes (e.g., sales, income). This public humiliation (or threat of) very often results in compliance.

[◀ Add Question Here](#)

Question 141 ▾ **Essay**

[Modify](#) [Remove](#)

Question

Briana lives in one state and works in the adjoining state. Both states tax the income she earns from her job. Does Briana have any relief from this apparent double taxation of the same income?

Answer Most states allow their residents some form of tax credit for the income taxes paid to other states. In Briana's case, the credit would be allowed by the state where she lives for the taxes paid to the state where she works.

[◀ Add Question Here](#)

Question 142 ▾ **Essay**

[Modify](#) [Remove](#)

Question

In early July 2012, Gavin is audited by the IRS and a large deficiency is assessed. In October of the same year, his income tax return for the state is audited. What has probably happened?

Answer The state has been notified by the IRS concerning the results of the July audit.

[◀ Add Question Here](#)

Question 143 ▾ **Essay**

[Modify](#) [Remove](#)

Question

Two months after the burglary of his personal residence, Eric is audited by the IRS. Among the items taken in the burglary was a shoe box containing approximately \$50,000 in cash. Eric is the owner and operator of a cash-and-carry liquor store. Eric wonders why he was audited. Can you help explain?

Answer Although Eric's audit by the IRS could be the result of sheer chance, this appears unlikely. Press coverage of the burglary, particularly if the items stolen were enumerated, could have put the IRS on notice. Why would anyone keep such a large amount of cash at his personal residence? Also, Eric is in a business where tax evasion is easily accomplished.

[◀ Add Question Here](#)

Question 144 ▾ **Essay**

[Modify](#) [Remove](#)

Question

Tracy has just been audited and the IRS agent has issued an RAR that assesses a large deficiency. Since Tracy disagrees with the result, her next step is to go to court. Do you agree?

Answer Tracy might save herself time and expense by going to the Appeals Division of the IRS. Here, the IRS has the authority to negotiate a settlement based on the "hazards of litigation" (i.e., the probabilities of winning or losing). If a settlement is

reached, resort to the courts is avoided.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 145 ▾ **Essay**

Question

Can a taxpayer start the 3-year statute of limitations on additional assessments by the IRS by filing his income tax return early (i.e., before the due date)? Can the period be shortened by filing late (i.e., after the due date)?

Answer The answer is *no* in both cases. When filing early, the statute starts to run on the due date of the return. When filing late however, the filing date controls.

[◀ Add Question Here](#)

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Question 146 ▾ **Essay**

Question

Brayden files his Federal income tax return by April 15, but does not pay the tax. Although he expects to pay interest on the large amount of tax he still owes, he feels that the timely filing has avoided any penalties. Is Brayden's assumption correct?

Answer Although Brayden has avoided the failure to file penalty, the failure to pay penalty will apply. It is 0.5% per month up to a maximum of 25% of the tax due as shown on the return.

[◀ Add Question Here](#)

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Question 147 ▾ **Essay**

Question

Compare civil fraud with criminal fraud with regard to the following:

- a. Penalties imposed.
- b. Degree of proof.

Answer a. Civil fraud results in a penalty of 75% of the deficiency attributable to fraud. Criminal fraud involves various fines and a possible prison sentence.

- b. In both cases, the burden of proof is on the IRS. In the case of criminal fraud, the IRS must show a degree of willfulness on the part of the taxpayer.

[◀ Add Question Here](#)

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Question 148 ▾ **Essay**

Question

Melinda has been referred to you by one of your clients. In the past, she has prepared her own income tax returns, but she has become overwhelmed by the increased complexity of the tax law. Consequently, Melinda wants you to prepare her return for calendar year 2012. In reviewing her 2011 return, you note that she has claimed as a deduction the entire cost of a business building that should have been capitalized and depreciated. What course of action should you follow?

Answer You should recommend to Melinda that an amended return be filed for 2011 correcting the error. If she refuses, you should assess the gravity of the error and how it impacts on your ability to file an accurate return for 2012. If you cannot do so, then you must decline the engagement.

[◀ Add Question Here](#)

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Question 149 ▾ **Essay**

Question

Your client, Connie, won \$12,000 in a football office pool. She sees no reason to include it in her income for several reasons. First, the amount won will not be reported to the IRS. Second, as an average income employee, she is unlikely to be audited by the IRS. Third, she feels that she has probably lost this much in other past office pools. How do you respond?

Answer As a practitioner, you cannot play the audit lottery. You must presume she will be audited irrespective of the probabilities. Although the use of estimates is allowed, Connie's assumptions as to her losses are not realistic. Even if they were reliable, gambling losses cannot be offset against gambling winnings but must be separately deducted. Thus, the \$12,000 must be reported as income or you cannot prepare Connie's return.

[◀ Add Question Here](#)

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Question 150 ▾ **Essay**

Question

Under what conditions is it permissible, from an ethical standpoint, for a CPA firm to outsource tax return preparation to a third party?

Answer First, the clients' confidentiality must be preserved. Second, the CPA firm must verify the accuracy of the work. Third, the clients must be advised as to the practice.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 151 ▾ **Essay**

Question

In terms of revenue neutrality, comment on a tax cut enacted by Congress that:

- a. contains revenue offsets.
- b. includes a sunset provision.

Answer a. Ideally, to achieve revenue neutrality all tax cuts should be accompanied by revenue offsets.

- b. A sunset provision does not account for the immediate revenue losses generated by a tax cut. It merely provides that such losses will not continue beyond a specified date when the tax cut expires and the former tax law is reinstated.

[◀ Add Question Here](#)

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Question 152 ▾ **Essay**

Question

The tax law contains various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain additional education. On what grounds can these provisions be justified?

Answer Social and economic considerations. As to the latter, a better educated workforce carries a positive economic impact.

[◀ Add Question Here](#)

[Modify](#) [Remove](#)

Question 153 ▾ **Essay**

Question

The tax law contains various provisions that encourage home ownership.

- a. On what basis can this objective be justified?
- b. Are there any negative considerations? Explain.

Answer a. Home ownership can be justified on economic and social grounds.

- b. Granting tax advantages to persons who are purchasing their homes places the taxpayers who rent at a disadvantage. The result is inequality in treatment.

[◀ Add Question Here](#)

Question 154 ▾ **Essay**

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Question

The tax law allows an income tax deduction for state and local income taxes. Explain why.

Answer The deduction for state and local income taxes can be justified on the grounds that it mitigates the double tax imposed on the same income.

[◀ Add Question Here](#)

Question 155 ▾ **Essay**

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Question

The tax law allows, under certain conditions, deferral of gain recognition for involuntary conversions.

- a. What is the justification for this relief measure?
- b. What happens if the proceeds are not entirely reinvested?

Answer a. By recognizing that the taxpayer's relative economic situation has not changed and that he or she lacks the wherewithal to pay a tax, any recognition of realized gain is deferred.

- b. If the proceeds from an involuntary conversion are not fully reinvested in property that is similar or related in service or use, recognized gain results. Such recognized gain cannot exceed realized gain and will be limited to the amount of the proceeds not reinvested. Recognition is based on the notion that the taxpayer now has the wherewithal to pay the tax that results.

[◀ Add Question Here](#)

Question 156 ▾ **Essay**

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Question

How do the net operating loss provisions in the tax law mitigate the effect of the annual accounting concept?

Answer Without the allowance of carryback and/or carryover provisions that apply the excess losses to profitable years, the losses would disappear. As shown by Example 25, this result places a business with profit and loss fluctuations on a more level playing field with one that maintains a stable income pattern.

[◀ Add Question Here](#)

Question 157 ▾ **Essay**

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Question

In connection with facilitating the function of the IRS in the administration of the tax laws, comment on the utility of the following:

- a. An increase in the amount of the standard deduction.
- b. Dollar and percentage limitations on the deduction of personal casualty losses.
- c. Availability of interest and penalties for taxpayer noncompliance.

Answer a. An increase in the amount of the standard deduction reduces the number of taxpayers who choose to itemize their personal deductions. This, in turn, cuts down on the deductions the IRS has to check.

- b. Limitations placed on casualty and theft losses curtail the number of taxpayers who can claim the deduction.
- c. The imposition of extra penalties, in addition to the tax owed, definitely deters taxpayer noncompliance.

[◀ Add Question Here](#)

Question 158 ▾ **Essay**

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Question

Congress reacts to judicial decisions that interpret the tax law in different ways. When it approves of a decision, Congress may act to amend the Code to incorporate the holding. When it disapproves, Congress may amend the Code to nullify its effect. Give an example of each one of these congressional reactions.

Answer Congress approved of the judicial conclusion that most stock dividends should be nontaxable and amended the Code to this effect. However, it disagreed as to when leasehold improvements should be taxed to a lessor. Consistent with the wherewithal to pay concept, the improvements are to be taxed on the termination of the lease. Thus, Congress overturned a judicial holding that would have taxed such improvements in the year they are made by the lessee.

[◀ Add Question Here](#)

OK