TT TEXTBOOK TESTBANKS

Solutions Manual for Fundamentals of Taxation for Individuals and Business Entities 2026 3rd Carnes

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Chapter 1—The Professional Practice of Taxation
End-of-Chapter Solutions

Discussion Questions

1. Describe the goal of tax planning.

Title: Discussion Question 1
Difficulty: Easy
Learning Objective 1: 1.1
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.1
Solution: The goal of tax planning is to maximize after-tax income. After-tax income is net income after reducing revenue for all expenses including federal income taxes. Tax planning should consider tax factors as well as non-tax factors.
Time On Task: 2 minutes

2. What is the formula to calculate an individual's taxable income?

Title: Discussion Question 2
Difficulty: Easy
Learning Objective 1: 1.2
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.2
Solution: The formula to calculate an individual's taxable income is as follows:

Gross income
Less: Deductions for adjusted gross income
Adjusted gross income
Less: Greater of standard deduction or itemized deductions
Less: Qualified business income deduction
Taxable income

Time On Task: 2 minutes

3. What form(s) is (are) used to file an individual's income tax return?

Title: Discussion Question 3
Difficulty: Easy
Learning Objective 1: 1.2

Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.2
Solution: Form 1040 is used to file an individual's income tax return information. Form 1040-SR can be used by those 65 and older.
Time On Task: 1 minute

4. Explain why a taxpayer with higher income does not have as large of a behavioral response to an increase in the tax rate as a lower-income taxpayer.

Title: Discussion Question 4
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.3
Solution: A lower-income taxpayer needs every after-tax dollar earned to pay bills and does not have much discretionary income. If the income tax rate increases, the lower-income taxpayer may have to work more hours at their current job or take on another job to have the same amount of after-tax income. A wealthier taxpayer may view the increased tax rate adversely but has more flexibility with their discretionary income. The wealthier taxpayer may view their leisure time as more important than working extra hours to earn the same after-tax pay.
Time On Task: 4 minutes

5. Differentiate between tax compliance and tax planning.

Title: Discussion Question 5
Difficulty: Easy
Learning Objective 1: 1.3
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.3
Solution: Tax planning is the process of estimating an individual's tax liability for multiple scenarios and/or multiple years and considering ways to reduce it. The appropriate goal for tax planning is to maximize after-tax income. After-tax income is net income after reducing revenue for all expenses including federal income taxes. Tax compliance is determining the tax effects for transactions that have already occurred, including the preparation of tax returns.
Time On Task: 4 minutes

6. Differentiate between an open transaction and a closed transaction.

Title: Discussion Question 6
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.3
Solution: An open transaction means that the proposed transaction is not yet completed. A closed transaction means that the relevant events have already happened, and the facts are set. This distinction is important because in an open transaction, the facts and results can be changed to achieve a better outcome. A closed transaction does not allow for this.
Time On Task: 3 minutes

7. What is the marginal tax rate? The average tax rate? The effective tax rate?

Title: Discussion Question 7
Difficulty: Easy
Learning Objective 1: 1.3
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.3
Solution: The marginal tax rate is the rate that applies to the next additional dollar earned. The average tax rate is total income tax divided by taxable income. The effective tax rate is total income tax divided by total income.
Time On Task: 3 minutes

8. Explain why a taxpayer would want to delay receipt of income or accelerate expenses into the current year.

Title: Discussion Question 8
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution: If a taxpayer is in a higher tax bracket in the current year and expects to be in a lower tax bracket next year, he would have tax savings from delaying the receipt of income to next year. If the current year's tax rate is higher, he would receive more tax benefit from accelerating deductible expenses into the current year rather than waiting until the next year when the marginal tax rate would be less.
Time On Task: 4 minutes

9. In what circumstances would it be better to accelerate income into the current year?

Title: Discussion Question 9
Difficulty: Easy
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution: It would be better to accelerate income into the current year if the taxpayer's current income tax rate is less than it will be in future years.
Time On Task: 2 minutes

10. Name three tax planning opportunities that taxpayers need to be familiar with.

Title: Discussion Question 10
Difficulty: Easy
Learning Objective 1: 1.3
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.3
Solution: Three of the following tax planning opportunities are:

- rates vary across different time periods
- rates vary across different jurisdictions
- rates vary across different types of income, and
- rates vary across different types of taxpayers.

Time On Task: 3 minutes

11. Discuss why the jurisdiction of a business might affect its after-tax cash flow.

Title: Discussion Question 11
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution: Tax rates may vary across different jurisdictions. This will result in more or less after-tax cash flow. The revenue generated may be the same, but the after-tax cash flow could be substantially different.
Time On Task: 3 minutes

12. Why is it important to identify the type of income earned or losses incurred?

Title: Discussion Question 12
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution: It is important to identify the character of the income earned because it is possible that different rates apply across the income types. Also, some character types may limit the amount of deduction allowed. Individuals currently pay tax at either 0%, 15%, or 20% on long-term capital gains and qualified dividend income. Interest income earned from a municipal bond is tax-exempt. And, for individuals, the maximum deduction per year for net capital losses is $3,000 per year. All these examples demonstrate the importance of the character of the income or loss.
Time On Task: 5 minutes

13. Which entity, an individual or a corporation, would pay more income tax on a net long-term capital gain of $10,000?

Title: Discussion Question 13
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution: A corporation will pay more tax on a net long-term capital gain than an individual. A corporation is a separate legal entity and pays tax at a flat 21%. An individual pays tax on long-term capital gains at a preferential rate of 0%, 15%, or 20%, depending on their filing status and income level.
Time On Task: 4 minutes

14. Explain static versus dynamic forecasting.

Title: Discussion Question 14
Difficulty: Hard
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application

Section Reference 1: 1.3
Solution: Tax = Rate × Base. Static forecasting assumes that the rate and base are independent of one another. Therefore, the tax base would not be affected by a change in the tax rate. Dynamic forecasting assumes there is a relationship (cause and effect) between the two variables. If the tax rate were to increase, it might not necessarily result in the desired outcome. For example, an increase in the gasoline tax might make a taxpayer reconsider their travel plans and take a vacation closer to home because the cost of gas has increased.
Time On Task: 6 minutes

15. Discuss the phrase "A dollar earned today is worth more than a dollar earned in the future."

Title: Discussion Question 15
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution: The time value of money results in a dollar received today being worth more than a dollar received later due to the effect that interest rates have on potential buying capacity. The value of a dollar changes over time because of interest rates. During an inflationary period, a dollar received in the future will not buy as much goods as the same dollar received today. Also, a dollar invested today will generate more interest than the same dollar invested at a later date.
Time On Task: 4 minutes

16. Which term describes a legal method of reducing taxes?

Title: Discussion Question 16
Difficulty: Medium
Learning Objective 1: 1.4
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.4
Solution: Tax avoidance describes a legal method of reducing taxes. The tax law provides tax planning opportunities, and a taxpayer is not expected to pay more than the amount required by law. Tax evasion means reducing taxes illegally.
Time On Task: 3 minutes

17. Why must a CPA be ethical when providing professional tax advice to others?

Title: Discussion Question 17
Difficulty: Medium

Learning Objective 1: 1.4
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application
Section Reference 1: 1.4
Solution: All professions have a code of conduct so that the general public knows that the individuals in that profession can be trusted. CPAs who engage in unethical conduct may be disciplined by the AICPA.
Time On Task: 3 minutes

18. Why are there two different sets of rules to govern the preparation of financial statements and the preparation of tax returns?

Title: Discussion Question 18
Difficulty: Medium
Learning Objective 1: 1.5
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.5
Solution: There are two sets of rules because each set serves a particular role and purpose. GAAP ensures that the financial statements are prepared fairly, accurately, and consistently across different business industries. Investors and creditors need to know that they can rely on the financial statements in making a sound investment decision. Congress creates tax laws to raise revenue and to meet other economic, social, and political objectives. For example, if a business has a lawsuit pending against it, a disclosure should be made on the financial statement, so an investor is aware of it before purchasing the company's stock. On the other hand, Congress will not allow a business to deduct the cost of a legal judgment while it is still pending and unclear as to its outcome.
Time On Task: 4 minutes

19. Provide an example of a social objective of the tax law.

Title: Discussion Question 19
Difficulty: Easy
Learning Objective 1: 1.6
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.6
Solution: Student answers will vary. One example of a social objective being met by a tax law is when an employer provides an employee benefit such as health insurance or a 401(k) plan for the benefit of the employees. There may be little direct business purpose for an employer to provide these benefits and they are costly, but it is socially desirable to encourage this behavior. By

allowing a deduction for these expenses Congress reduces the cost of providing these to the employee. There are numerous correct answers including an employer providing disability insurance, reimbursement for adoption expenses, or reimbursement for education by the employee.
Time On Task: 3 minutes

20. Provide an example of an economic objective of the tax law.

Title: Discussion Question 20
Difficulty: Easy
Learning Objective 1: 1.6
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.6
Solution: An example of an economic objective being met by a tax law is Section 179 and bonus depreciation. The IRC allows businesses to immediately deduct the cost of purchasing qualified assets that normally would be capitalized and written off over the asset's useful life. Allowing businesses to take an immediate deduction results in large tax savings for the business and is intended to stimulate the economy. Another example is the preferential tax rate on long-term capital gains and qualified dividend income.
Time On Task: 3 minutes

21. Describe horizontal equity and vertical equity.

Title: Discussion Question 21
Difficulty: Medium
Learning Objective 1: 1.6
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.6
Solution: Horizontal equity provides that taxpayers in similar situations should pay similar amounts of tax. Significant factors can affect the ability to pay such as marital status, dependents, and health. Vertical equity provides that taxpayers with a greater ability to pay contribute more in taxes than taxpayers with less ability to pay. Vertical equity focuses on a fair rate structure to calculate the tax liability.
Time On Task: 4 minutes

22. Name three other types of taxes besides the income tax that an individual may have to pay.

Title: Discussion Question 22
Difficulty: Easy

Learning Objective 1: 1.7
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.7
Solution: Besides income tax, an individual may have to pay property taxes if they own a home, gift tax if they make a gift above the lifetime threshold, or sales tax on the purchase of goods. Other examples include employment taxes and excise taxes.
Time on Task: 2 minutes

23. Hoffman Inc.'s tax liability increased by $55,000 this year, so it decided to reduce the dividend paid to its shareholders by $55,000. Who bears the incidence of the increase in tax liability?

Title: Discussion Question 23
Difficulty: Medium
Learning Objective 1: 1.7
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Measurement Analysis and Interpretation
Standard 3: Bloom's || Application
Section Reference 1: 1.7
Solution: Hoffman Inc.'s shareholders bear the incidence of the increase in tax liability because the corporation reduced the dividend paid.
Time On Task: 3 minutes

24. Discuss the different specialty areas in which a person may work in as a tax professional.

Title: Discussion Question 24
Difficulty: Easy
Learning Objective 1: 1.8
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.8
Solution: A career in tax can include working as a public accountant, corporate accountant, federal or state/local government accountant, data analyst, estate planner, investment strategist, or attorney, to name a few.
Time On Task: 3 minutes

Multiple Choice Questions

1. Which of the following is not an appropriate aspect of effective tax planning?
a) Maximizing after-tax income.

b) Considering tax costs and non-tax costs.
c) Minimizing taxes paid.
d) Considering the tax effects of all financial transactions.

Answer: c
Title: Multiple Choice Question 1
Difficulty: Medium
Learning Objective 1: 1.1
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.1
Solution:
The correct answer is minimizing taxes paid.
Minimizing taxes is not an effective tax planning tool. Were that the goal, then the ultimate success would be to reduce a taxpayer's tax liability to zero—actually an easy goal to meet. If a taxpayer has no income for the year, then there will be no tax liability, and you will have minimized their taxes. But your client will also be a very poor and hungry person, so this cannot be the proper goal
Time On Task: 2 minutes

2. Which of the following forms is used to complete and file an individual tax return?
a) Form 1120
b) Form 1040
c) Form 1065
d) Form 709

Answer: b
Title: Multiple Choice Question 2
Difficulty: Easy
Learning Objective 1: 1.2
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.2
Solution: The correct answer is Form 1040.
Form 1040 is used to complete and file an individual tax return.
Time On Task: 1 minute

3. Which of the following forms is used to complete and file an individual tax return?
a) Form 1120
b) Form 1040
c) Form 1065
d) Form 709

Answer: c
Title: Multiple Choice Question 3
Difficulty: Medium
Learning Objective 1: 1.2
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.2
Solution: The correct answer is a taxpayer can deduct the greater of itemized deductions or the standard deduction.
A taxpayer can deduct the greater of his standard deduction based on filing status or his itemized deductions.
Time On Task: 3 minutes

4. Which tax rate is best to use in tax planning?
a) Marginal tax rate
b) Average tax rate
c) Effective tax rate
d) None of the these

Answer: a
Title: Multiple Choice Question 4
Difficulty: Easy
Learning Objective 1: 1.3
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.3
Solution: The correct answer is marginal tax rate.
The marginal tax rate is used in tax planning because one must consider the tax liability on the next dollar earned.
Time On Task: 2 minutes

5. Which of the following does not present a tax planning opportunity?
a) Difference in tax rates across jurisdictions
b) Difference in tax rates across time periods
c) Difference in tax rates across entity types
d) All are examples of tax planning opportunities.

Answer: d
Title: Multiple Choice Question 5
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Knowledge

Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution:
The correct answer is all are examples of tax planning opportunities.
Jurisdiction, time period, and entity type all provide opportunities for tax planning.
Time On Task: 4 minutes

6. Which of the following statements is true concerning tax compliance?
a) Taxpayers do not have to report income unless it is more than $100.
b) Tax compliance is generally the same across all types of income.
c) Tax compliance for farm income is higher than tax compliance for wages.
d) Tax compliance for wages is higher than tax compliance for farm income.

Answer: d
Title: Multiple Choice Question 6
Difficulty: Easy
Learning Objective 1: 1.4
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.4
Solution:
The correct answer is tax compliance for wages is higher than tax compliance for farm income. According to Illustration 1.5, the percentage of income underreported by wages is only 1%. The percentage of income underreported by farm income is 64%. While the noncompliance rate for farmers is high, an analysis of IRS data shows that the average amount of underreported farm income was less than $4,500, which is significantly less than the amount from bars and restaurants.
Time On Task: 2 minutes

7. Which of the following is an example of tax evasion?
a) Taxpayer A accelerates her deductible expenses into December of the current year because she anticipates that her tax rate will be lower next year.
b) Taxpayer B has her child on December 30 to claim the child tax credit in the current year.
c) Taxpayer C owns a candy store (customers may only pay in cash) and does not report any of the $33,000 income received.
d) Taxpayer D omits dividend income of $28 from his return because he did not realize he lost his Form 1099-DIV that reported it to him.

Answer: c
Title: Multiple Choice Question 7
Difficulty: Medium
Learning Objective 1: 1.4
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting

Standard 3: Bloom's || Application
Section Reference 1: 1.4
Solution: The correct answer is Taxpayer C owns a candy store (customers may only pay in cash) and does not report any of the $33,000 income received.
Willful underreporting of income is an example of tax evasion. Losing a tax form, such as a Form 1099, and therefore not reporting income, is not tax evasion.
Time On Task: 3 minutes

8. Which of the following is not an objective of the federal income tax system?
a) Raise revenue
b) Ensure the tax law is equitable
c) Tax only the rich and never the poor
d) Meet specified social objectives

Answer: c
Title: Multiple Choice Question 8
Difficulty: Easy
Learning Objective 1: 1.6
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.6
Solution: The correct answer is to tax only the rich and never the poor.
The goals of tax policy makers include raising revenue, social objectives, economic objectives, equity objectives and political objectives. The tax system is not designed to tax only the rich and never the poor.
Time On Task: 2 minutes

9. Which of the following policy objectives describes the disallowance of entertainment expenses?
a) Political
b) Equity
c) Economic
d) Social

Answer: b
Title: Multiple Choice Question 9
Difficulty: Easy
Learning Objective 1: 1.6
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.6
Solution: The correct answer is equity.

The disallowance of entertainment expenses is equitable because of the pleasure element of the business activity. Other taxpayers do not receive a deduction for this type of activity because it is personal, so business owners should not either.
Time on Task: 2 minutes

10. All of the following are examples of taxes that might be paid by individuals to the government except:
a) Implicit tax
b) Income tax
c) Sales tax
d) Gift tax

Answer: a
Title: Multiple Choice Question 10
Difficulty: Medium
Learning Objective 1: 1.7
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.7
Solution: The correct answer is implicit tax.
Implicit taxes arise when Congress creates a tax advantage that increases the cost of that asset, but these additional costs (implicit taxes) are not paid directly to the government.
Time On Task: 3 minutes

11. Which certification is most popular among tax accountants?
a) Certified Financial Planner
b) Certified Public Accountant
c) Attorney
d) Certified Estate Planner

Answer: b
Title: Multiple Choice Question 11
Difficulty: Easy
Learning Objective 1: 1.8
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.8
Solution: The correct answer is Certified Public Accountant.
A CPA designation is the most popular certification for tax accountants. The other certifications are also helpful for accountants.
Time On Task: 1 minute

12. Which of the following is a possible career in taxation?
a) Corporate accounting
b) Public accounting
c) Government accounting
d) All of these

Answer: d
Title: Multiple Choice Question 12
Difficulty: Easy
Learning Objective 1: 1.8
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.8
Solution: The correct answer is all of these.
All the choices presented are possible careers in taxation.
Time On Task: 2 minutes

Brief Exercises

1. Narayani is single and has taxable income in 2025 of $90,000. She is considering working as a freelance designer and will earn an additional $20,000. Disregarding self-employment tax, what would Narayani's after-tax income be on the $20,000 if she is in the 24% tax bracket?

Title: Brief Exercise 1
Difficulty: Medium
Learning Objective 1: 1.1
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.1
Answer: $15,200
Solution:

Taxable income received	$20,000	
Less: Tax cost	(4,800)	($20,000 × 24%)
After-tax income	$15,200	

Time On Task: 4 minutes

2. Briefly describe supporting Schedules 1, 2, and 3 for Form 1040.

Title: Brief Exercise 2
Difficulty: Easy
Learning Objective 1: 1.2

Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.2
Solution: Schedule 1 is used to report additional income items and adjustments to income in calculating AGI. Schedule 2 is used to report additional taxes that might be incurred by the taxpayer. Schedule 3 is used to report additional credits and payments made by the taxpayer.
Time On Task: 2 minutes

3. Jasmine is single and in the 35% marginal tax bracket. She gifts stock to her father with a fair market value of $50,000 that earns non-qualified dividend income of $4,300 in 2025 (meaning that the dividend income is taxed at ordinary income rates). Her dad is in the 12% marginal tax bracket. What is the overall tax saving for the family in this scenario?

Title: Brief Exercise 3
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer: $989
Solution: The father will pay tax on the $4,300 of dividend income at a 12% rate, a saving of $989 for the family ($8,000 × (35% – 12%)).
Time On Task: 4 minutes

4. Discuss why tax evasion is a significant issue for the federal government.

Title: Brief Exercise 4
Difficulty: Easy
Learning Objective 1: 1.4
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.4
Solution: Tax evasion is a significant issue particularly for income taxes. The government has estimated that $1 out of every $6 (about 16%) that should be paid as federal income taxes is not. This percentage would have resulted in underpayment of taxes of approximately $696 billion in 2022.
Time On Task: 3 minutes

5. What is the main purpose of GAAP and the main purpose of the tax laws?

Title: Brief Exercise 5
Difficulty: Easy
Learning Objective 1: 1.5
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.5
Solution: The purpose of GAAP is to provide financial statements that are useful for decision making by investors, creditors, employees, and other users of the information. The main purpose of the tax laws, by contrast, is to generate revenue to fund the federal government.
Time On Task: 3 minutes

6. List the five main goals that policymakers attempt to achieve with the income tax system.

Title: Brief Exercise 6
Difficulty: Easy
Learning Objective 1: 1.6
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.6
Solution: The five main goals that policymakers attempt to achieve with the income tax system are to raise revenue, promote social objectives, stimulate or decelerate economic growth, increase fairness, and political goals.
Time On Task: 3 minutes

7. Dexter earns wages of $88,000 in 2025. What are the total employment taxes paid on the wages?

Title: Brief Exercise 7
Difficulty: Medium
Learning Objective 1: 1.7
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.7
Answer: $13,464
Solution: Total employment taxes are $13,464 ($88,000 × 7.65% × 2).
Time On Task: 2 minutes

8. List five characteristics of a successful tax professional.

Title: Brief Exercise 8

Difficulty: Easy
Learning Objective 1: 1.8
Standard 1: AACSB || Knowledge
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Knowledge
Section Reference 1: 1.8
Solution: Characteristics of a successful tax professional include:

- Integrity
- Problem-solving skills
- Analytical skills
- Oral and written communication skills
- Listening skills
- Research skills
- Technology agility
- Conflict resolution skills

Time On Task: 2 minutes

Application Problems

1. Calculate the tax liability for the following taxpayers in 2025:
a) Darius is single and has taxable income of $100,000.
b) Henry and Harriet are married and file a joint tax return. They have taxable income of $200,000.
c) Jenny is head of household and has taxable income of $100,000.

Title: Application Problem 1
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer:

a. $16,914
b. $33,828
c. $15,175

Solution:

a. Darius has a tax liability of $16,914 [($100,000 – $48,475) × 22% + $5,578.50]
b. Henry and Harriet have a tax liability of $33,828 [($200,000 – $96,950) × 22% + $11,57]
c. Jenny has a tax liability of $15,175 [($100,000 – $64,850) × 22% + $7,442]

Time On Task: 6 minutes

2. What is the after-tax income in the following situations for a single taxpayer in 2025?
a) Taxable income received of $100,000.
b) Taxable income received of $75,000, tax-exempt revenue received of $25,000.

Title: Application Problem 2
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer:

a. $83,086
b. $88,586

Solution:

a. Taxable income received	$100,000	
Less: Tax cost	(16,914)	([$100,000 – $48,475] × 22% + $5,578.50)
After tax income	$ 83,086	

b. Taxable income received	$ 75,000	
Plus: Tax exempt income received	25,000	
Revenue received	$100,000	
Less: Tax cost on $75,000	(11,414)	([$75,000 – $48,475] × 22% + $5,578.50)]
After tax income	$ 88,586	

Time On Task: 8 minutes

3. What is the after-tax cost in the following situations if the taxpayer has additional deductions as stated? Assume the taxpayer is in the 24% marginal tax bracket.
a) Deductible expense paid of $35,000.
b) Deductible expense paid of $25,000; non-deductible expense paid of $10,000.

Title: Application Problem 3
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer:

a. $26,600
b. $29,000

Solution:

a. Deductible expense paid	$ 35,000
Less: Tax savings @ 24%	(8,400)
After-tax cost	$ 26,600

b. Deductible expense paid	$ 25,000
Plus: Non-deductible expense paid	10,000
Expenses paid	$ 35,000
Less: Tax savings on $25,000 @ 24%	(6,000)
After-tax cost	$ 29,000

Time On Task: 8 minutes

4. Dre owns Kratum Company and has the following revenue and expenses. Calculate the after-tax net profit (ignoring self-employment tax) for Dre who is single in 2025.

Taxable revenue received	$125,000
Tax-exempt revenue received	$15,000
Deductible business expenses paid	$4,000
Deductible itemized expenses	$18,000
Non-deductible expenses paid	$5,000

Title: Application Problem 4
Difficulty: Hard
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer: $95,426
Solution:

Taxable revenue received	$125,000	
Less: Deductible business expenses paid	(4,000)	
Less: Deductible itemized deductions	(18,000)	
Net taxable income	$103,000	
Less: Tax cost – Single	(17,574)	([$103,000 – $48,475] × 22% + $5,578.50]
After-tax taxable income	$ 85,426	
Plus: Tax-exempt revenue received	15,000	
Less: Non-deductible expenses paid	(5,000)	
After-tax net profit	$ 95,426	

Time On Task: 8 minutes

5. Sanjay has the following information for 2025:

Filing status	Married filing jointly
Taxable income	$260,700
Total income	$290,700

Compute his marginal tax rate, average tax rate, and effective tax rate.

Title: Application Problem 5
Difficulty: Medium

Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer: Marginal: 24%, Average: 18.51%, Effective: 16.60%
Solution:

For MFJ, if taxable income is	The tax is:
Over $206,700 but not over $394,600	$35,302 plus 24% of the excess over $206,700

Taxable income	$260,700	
Less: Threshold for 24% bracket	(206,700)	
Income taxed at 24%	$ 54,000	
	× 24%	
	$ 12,960	
Plus: Tax on $206,700	$ 35,302	
Tax liability	$ 48,262	
Marginal tax rate	24%	
Average tax rate	18.51%	($48,262/$260,700)
Effective tax rate	16.60%	($48,262/$290,700)

Time On Task: 8 minutes

6. Sarah has asked for help in determining whether she should receive her $25,000 bonus check in the current year or next year. In the current year, her marginal tax rate is 24% and she anticipates she will be in the 32% marginal tax bracket next year. What advice can you give Sarah?

Title: Application Problem 6
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution:

	Current year	Next year
Bonus	$ 25,000	$ 25,000
× Marginal tax rate	× 24%	× 32%
Tax cost	$ 6,000	$ 8,000
Net revenue from bonus	$ 19,000	$ 17,000

Sarah should choose to receive her bonus in the current year because it provides $2,000 more after-tax revenue.

Time On Task: 6 minutes

7. Aroon is a valuable employee for his company, and he will receive a significant bonus. His employer has asked him to consider moving next year to a new company location in a different state. His bonus is guaranteed and projected to be $75,000. Aroon can choose to receive the bonus on December 31 of the current year or January 1 of the next year. You are able to determine the following information:

	Marginal tax rate	**State tax rate**
Current year	24%	10%
Next year	32%	5%

Should Aroon choose to receive his bonus in the current year or next year?

Title: Application Problem 7
Difficulty: Medium
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer: Current year
Solution: Aroon has two tax rates that are changing from the current year to the next year. The federal marginal tax rate is increasing from 24% to 32%, while his state marginal tax rate is decreasing from 10% to 5%. To make a proper decision, you need to analyze Aroon's combined federal and state marginal tax rates.

	Federal rate	State rate	Total rate
Current year	24%	10%	34%
Next year	32%	5%	37%

Aroon should take the bonus this year because his combined marginal tax rate is 3 percentage points (37% – 34%) less in the current year versus next year. His increased tax savings by receiving the bonus in the current year is $2,250 ($75,000 × 3%).
Time On Task: 8 minutes

8. Kurt, married filing jointly, owns a manufacturing business and has the opportunity to invest in a transaction that will generate $200,000 before-tax cash flow and taxable income in Year 0.
a) Calculate the after-tax cash flow using the tax table for 2025 for married filing jointly.
b) How does your answer change if Kurt could restructure the transaction in a way that results in before-tax cash flow and taxable income of $50,000 in Year 0, $100,000 in Year 1, and $50,000 in Year 2? Assume a discount factor of 4% and the same tax rate table as given for 2025.

Title: Application Problem 8
Difficulty: Hard
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting

Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer:

a. $166,172
b. $170,439

Solution:

a. Original transaction:

	Year 0
Taxable income	$200,000
Tax cost	$ 33,828 ([$200,000 – $96,950] × 22% + $11,157]
Before-tax cash flow	$200,000
Less: Tax cost	(33,828)
Net cash flow	$166,172
Net present value	$166,172

b. Restructured transaction:

	Year 0	Year 1	Year 2
Taxable income	$50,000	$100,000	$50,000
Tax cost	$ 5,523[1]	$ 11,828[2]	$ 5,523[3]
Before-tax cash flow	$50,000	$100,000	$50,000
Less: Tax cost	(5,523)	(11,828)	(5,523)
Net cash flow	$44,477	$88,172	$44,477
Discount factor (@ 4%)		× 0.962	× 0.925
Present value	$44,477	$84,821	$41,141
Net present value	$170,439		

Kurt should try to restructure the transaction because it results in a higher net present value of $170,439.
[1] [($50,000 – $23,850) × 12% + $2,385]
[2] [$100,000 – $96,950) × 22% + $10,852]
[3] [($50,000 – $23,850 × 12% + $2,385]

Time On Task: 12 minutes

9. Butch, single, operates a sole proprietorship with net income of $145,000. Butch's taxable income is also $145,000 including the income from the sole proprietorship. Butch is considering incorporating his business. Calculate the income tax liability for Butch as a sole proprietor (ignoring self-employment tax) and as a corporation in 2025. List two other factors that Butch should consider before deciding to incorporate.

Title: Application Problem 9
Difficulty: Hard
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting

Standard 3: Bloom's || Application
Section Reference 1: 1.3
Solution:
As a sole proprietor, Butch would incur tax of $27,647 ([$145,000 – $103,350] × 24% + $17,651). As a corporation, the corporation would incur tax of $30,450 ($145,000 × 21%).
Factors that should be considered before incorporating include:

a. Will the business continue to operate at a profit?
b. What will be the administrative costs of becoming a corporation?
c. What taxes are imposed at the state and local level?
d. What is the effect of double taxation?

Time On Task: 8 minutes

10. Barb and Rick are married filing jointly and have taxable income of $100,000.
a) Calculate their tax liability using the 2025 tax rate schedules.
b) Calculate their tax liability using a flat rate of 20%.

Title: Application Problem 10
Difficulty: Easy
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer:

a. $11,828
b. $20,000

Solution:

a. Progressive tax rate tax liability = $11,828 ([$100,000 – $96,950] × 22% + $11,157]
b. Flat tax rate tax liability = $20,000 ($100,000 × 20%)

Time On Task: 4 minutes

11. Quincy is single, has $65,000 of wages, and pays 20% in federal and state income tax. If the combined federal and state tax rate increases to 25%, how much additional income must Quincy earn to maintain the same desired take-home pay in 2025?

Title: Application Problem 11
Difficulty: Hard
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.3
Answer: $4,333

Solution: Quincy's take-home pay at 20% is \$52,000 [\$65,000 – (100% – 20%) × \$65,000]. To remain at \$52,000 after the tax rate is increased to 25%, Quincy will have to earn \$69,333:

Desired take-home pay = Pre-tax pay / (100% – 25%) = \$52,000/75% = \$69,333

Therefore, he will have to earn an additional \$4,333 to maintain the same take-home pay.

Time On Task: 8 minutes

12. The state Nor lives in has the following income tax rate structure:

Percentage rate	**Bracket**
8%	Income from \$0−\$100,000
5%	Income from \$100,001−\$200,000
3%	Income in excess of \$200,000

Nor has \$325,000 of income. Calculate Nor's tax liability and indicate what type of tax rate structure his state has.

Title: Application Problem 12
Difficulty: Medium
Learning Objective 1: 1.6
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.6
Answer: \$16,750, Regressive
Solution:

Taxable income	Tax computation	Tax
\$325,000	8% of \$100,000	\$8,000
	5% of \$100,000	5,000
	3% of \$125,000	3,750
Total tax liability		\$16,750

This state has a regressive tax rate structure because the rate decreases as the base increases.

Time On Task: 5 minutes

13. Dorice lives and works in Indiana but purchased a car from a dealership in Illinois. The sales tax in Indiana is 7% and in Illinois, it is 6.25%. Did Dorice avoid having to pay the additional 0.75% sales tax by purchasing her car in Illinois?

Title: Application Problem 13
Difficulty: Medium
Learning Objective 1: 1.7
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.7

Answer: No
Solution: No, Dorice will have to pay a use tax of 0.75% to the state of Indiana. A use tax is levied on the sales price of goods that are owned or consumed within a state but were not purchased within that state.
Time On Task: 3 minutes

14. Benny has $100,000 to invest and is considering two options:
Option A: Earn 6%, investment income is taxable
Option B: Earn 4.8%, investment income is tax-exempt
Benny has a 24% marginal tax rate.
a) What is Benny's explicit and implicit tax on both options?
b) Which option provides the greater annual after-tax cash flow?

Title: Application Problem 14
Difficulty: Medium
Learning Objective 1: 1.7
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Reporting
Standard 3: Bloom's || Application
Section Reference 1: 1.7
Answer:

a. Option A implicit tax: $0; Option A explicit tax: $1,440; Option B implicit tax: $1,200; Option B explicit tax: $0
b. Option B

Solution:

a. Option A generates before-tax income of $6,000 ($100,000 × 6%). Option B generates before-tax income of $4,800 ($100,000 × 4.8%). Benny pays explicit tax of $1,440 ($6,000 × 24%) and $0 implicit tax on Option A. Benny pays no explicit tax and $1,200 of implicit tax on Option B. The implicit tax of $1,200 is the difference between the before-tax return on the taxable investment and the tax-exempt investment.
b. Option A results in after-tax tax cash flow of $4,560 ($6,000 – $1,440). Option B results in after-tax cash flow of $4,800. Benny should choose Option B.

Time On Task: 6 minutes

Tax Planning Problems

1. McKeller Company would like to start a new venture. The company is currently in the 24% marginal tax bracket and uses a 5% discount factor. The company projects that the venture will produce before-tax cash flows of $10,000 in Year 0, $20,000 in Year 1, and $30,000 in Year 2.
a) Assume that taxable income and the before-tax cash flows are equal in the year received, and compute the present value of the cash flows.
b) What if the company can defer receipt of cash flow from Year 0 and Year 1 until Year 2? Recompute the present value of cash flows.

c) Assume the same facts in part a, except the company can delay paying any tax on cash flows from Years 0 and 1 until Year 2. Recompute the new present value of cash flows.
d) Which option provides the best outcome?

Title: Tax Planning Problem 1
Difficulty: Hard
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || PC: Decision Making
Standard 3: Bloom's || Analysis
Section Reference 1: 1.3
Answer:

a. $42,750
b. $41,359
c. $43,189
d. Option c

Solution:

a.	**Year 0**	**Year 1**	**Year 2**
Before-tax cash flow/ taxable income	$10,000	$20,000	$30,000
Less: Tax cost at 24%	(2,400)	(4,800)	(7,200)
After-tax cash flow	$7,600	$15,200	$22,800
Discount factor (@ 5%)		0.952	0.907
Present value	$ 7,600	$14,470	$20,680
NPV	$42,750		

b.	**Year 0**	**Year 1**	**Year 2**
Before-tax cash flow/taxable income	-0-	-0-	$60,000
Less: Tax cost at 24%			(14,400)
After-tax cash flow			$45,600
Discount factor (@ 5%)			0.907
Present value			$41,359
NPV			$41,359

c.	**Year 0**	**Year 1**	**Year 2**
Before-tax cash flow/ taxable income	$10,000	$20,000	$30,000
Less: Tax cost at 24%			(14,400)
After-tax cash flow	$10,000	$20,000	$15,600
Discount factor (@ 5%)		0.952	0.907
Present value	$10,000	$19,040	$14,149
NPV			$43,189

d. Option c provides the highest net present value.

Time On Task: 15 minutes

2. Rafael is thinking of starting an office supplies business specializing in home and office delivery. He is not sure what entity type is best from a tax perspective and needs your help. He projects that he will generate net cash flow and taxable income of $50,000 in his first year.
a) Compare and compute the difference in after-tax cash flow if Rafael structures his business as a C corporation which has a 21% flat rate or an S corporation which has income flowing to him on his personal return at a 24% rate.
b) What are some other concerns that Rafael should consider?

Title: Tax Planning Problem 2
Difficulty: Hard
Learning Objective 1: 1.3
Standard 1: AACSB || Analytic
Standard 2: AICPA || PC: Decision Making
Standard 3: Bloom's || Analysis
Section Reference 1: 1.3
Answer: a. C corporation after-tax cash flow: $39,500; S corporation after-tax cash flow: $38,000
Solution:

a.

	C corporation	S corporation
Net profit	$50,000	$50,000
Less: Tax cost ($50,000 × marginal rate*)	(10,500)	(12,000)
After-tax cash flow	$39,500	$38,000

*The marginal rate for the C corporation is 21% and for Rafael is 24%.

b. Rafael should consider how the corporation's payments are taxed, how losses are treated by both entity types, state income taxes, and how the type of the income items generated are taxed.

Time On Task: 10 minutes

Communication Problem

1) **Careers in Taxation** Being a full-time accountancy student is exciting and challenging. You are aware that there are many careers within accountancy to choose from, but your interest has been in taxation. Explain to your family why you would like to be a tax accountant and discuss the different career paths within taxation that you can explore.

Title: Communication Problem: Careers in Taxation
Difficulty: Easy
Learning Objective 1: 1.8
Standard 1: AACSB || Communication
Standard 2: AICPA || PC: Communication
Standard 3: Bloom's || Analysis

Section Reference 1: 1.8
Solution:
Dear Mom and Dad,

College has been great so far and I am learning a lot. As you know, I have chosen accounting as my major, and I would like to focus on the area of taxation. Some qualities that a good tax accountant needs are to be detail-oriented, a good listener and observer, a great problem solver, and an excellent communicator. Most people think accountants just sit behind a desk and crunch numbers, but there is so much more! I would like to sit for the CPA exam and become a certified public accountant.

There are so many career choices within taxation that I am exploring. As a public accountant, I can advocate for my clients. I will be involved in tax compliance, research, planning, and decision-making. As a corporate tax accountant, I will get to work in a team environment with other departments within the company, adding valuable input and contributing to the decision-making for the betterment of the company. I can work in corporate tax, sales and use tax, international tax, property tax, or state and local tax, to name just a few. I also learned about other areas that I wasn't as familiar with such as investment planning, estate planning, valuation work, or working for a government agency such as the IRS or a state or local government. I could even work for the FBI; wouldn't that be cool! Lastly, I could continue my schooling and become a tax attorney. So many options! I hope all is well at home.

Miss you guys,
Time On Task: 10 minutes

Ethics and Professional Responsibilities Problem

1. Preparing a Tax Return A friend of yours has approached you about preparing his tax return. You are in your senior year of college taking a taxation course, and everyone keeps asking you questions and seeking your advice on how to prepare their tax returns and get the largest tax refund possible. You have told them that you have only taken one course so far and are not a CPA. Can you prepare your friend's tax return? Can you accept payment? In addition to the chapter content, see *Statements on Standards for Tax Services* at www.aicpa-cima.com/resources/landing/statements-on-standards-for-tax-services, *Circular 230* at www.irs.gov/tax-professionals/office-of-professional-responsibility-and-circular-230, and Chapter 3, LO4, Tax Professional

Title: Ethics Problem: Preparing a Tax Return
Difficulty: Medium
Learning Objective 1: 1.4
Standard 1: AACSB || Ethics
Standard 2: AICPA || PC: Ethical Conduct
Standard 3: Bloom's || Evaluation
Section Reference 1: 1.4
Solution: Anyone can prepare a tax return. You may give advice, help someone prepare their return, or prepare the return yourself. Your friend or anyone else that you give advice to should

know that you are a student and not well versed yet on the complexities of the tax law. If you prepare your friend's return, you may not accept compensation. Then, the law considers you a paid preparer and there are more stringent rules for this designation.

A paid preparer must have an IRS-issued preparer tax identification number (PTIN) in order to legally prepare a tax return for compensation. Under *Circular 230* §10.3, practice before the IRS is limited to CPAs, attorneys, and enrolled agents and they have unlimited representation rights. Only in limited situations may a person other than a CPA, attorney, or enrolled agent be allowed to practice before the IRS. *Circular 230* §10.35 states that a practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.

You may give advice to your friend or prepare your friend's tax return, but you should not receive payment. As a student, you do not yet have the knowledge needed to take on the legal responsibility of signing tax returns as a paid preparer.
Time On Task: 10 minutes

Research Problem

1. Is the Tax Law Constitutional? Peter "The Prophet" Verdad is a self-proclaimed prophet who claims that the end of times is near. He earns income as a guest lecturer, from the sale of prophecy books and videos, and as a host at a popular radio station. Peter did not file an income tax return for tax years 2011–2018, claiming that the federal income tax system is unconstitutional. He also claims that he shouldn't have to pay tax because he is essentially the same as a church. What would be your response to Peter if he were your client? Hint: See Lloyd v. Commissioner, T.C. Memo. 2020-92 (2020).

Title: Research Problem: Is the Tax Law Constitutional?
Difficulty: Medium
Learning Objective 1: 1.4
Standard 1: AACSB || Analytic
Standard 2: AICPA || AC: Research Standard 3: Bloom's || Analysis
Section Reference 1: 1.4
Solution: Peter must report the income earned, file tax returns, and pay tax on any resulting liability, plus penalty and interest. The income was generated from services performed and the sale of material related to his activity. Peter does not consider himself a business, but rather a not-for-profit organization that should not pay tax. In *Lloyd v. Commissioner*, T.C. Memo. 2020-92 (2020), where the petitioner represented himself, neither the IRS nor the Tax Court was swayed by Lloyd's similar arguments. According to the court, Lloyd identified his role at Christian Media Network as "pastor, prophet, leader, [and] spokesperson," and at trial, stated that "'in effect,' he is 'Christian Media.'" However, the court noted that Christian Media Network was never operated under a separate legal entity and that Lloyd himself was not a licensed or ordained minister.
Time On Task: 12 minutes