**Chapter 1**

**Introduction to Tax**

**Why Study Taxes?**

**Definition of a Tax – 3 Elements**

**Example:** Are the following taxes?

1) Marriage license fee?

2) Increased sales tax to pay for road construction?

3) Postage paid to mail a package?

4) Property taxes on a home?

5) Speeding ticket?

**Major Types of Taxes**

1) Income Taxes – Largest Revenue Raiser, Individual in Larger

2) Employment and Unemployment Taxes

3) Excise taxes

4) Transfer Taxes – estate taxes and gift tax

5) Sales and Use Taxes

6) Property Taxes

7) Implicit Taxes

**Tax Rate Structures**

1. Proportional/Flat
2. Progressive
3. Regressive

**Federal Income Tax**

1. Statutory Authority- Constitution 16th Amendment, Treaties, Internal Revenue Code
2. Interpretive Authority – Treasury Regulations, Internal Revenue Service Rulings, Procedures, Notices, Legislative Committee Reports
3. IRS Administrative Process (Typically Prior to Courts)
4. Judicial Interpretation of Law – Precedent – Stare Decisis, Golsen Rule (Tax Court)

* Trial Courts – Tax Court, U.S. District Court, Court of Claims – Taxpayer Options
* Appellate Courts – U.S. Court of Appeals (Various Circuits)
* U. S. Supreme Court – Ultimate Authority

**NOTE:** The Three Branches of Government are Represented

1. Primary vs Secondary Authorities

**Tax Research Process**

1. Understand FACTS (Important) – Discuss practical applications – mistakes, litigation
2. Identify Issues
3. Locate Relevant Authorities
4. Analyze Authorities
5. Document/Communicate - Discuss practical applications

**Tax Legislative Process**

Players:

* The House of Representatives – Ways and Means Committee
* The Senate
* The President

Reconciliation Process vs. Permanent Legislation

**How to Calculate a Tax**

Taxable Income

Tax liability = tax base\*tax rate

Tax Base

Statutory Tax Rate

**Tax Rates**

**(1) Statutory tax rate**

*Tax Rates Used for Budgeting and Planning*

**(2) Marginal tax rate (MTR)** – rate of tax or savings that applies to *additional* taxable income or deductions.

**(3) Average tax rate (ATR)** – average rate of tax on each dollar of taxable income.

**(4) Effective tax rate (ETR)** – average rate of tax on *economic* income, where economic income is both taxable and nontaxable income (total income).

**Examples**

**1)** Assume the following tax brackets are legitimate and that a client has $60,000 of economic income of which $35,000 is taxable.

|  |  |
| --- | --- |
| **Tax Bracket** | **Rate** |
| 0 - $10,000 | 10% |
| $10,001 - $20,000 | 20% |
| $20,001 - $50,000 | 30% |
| $50,001 and up | 40% |

What is the client’s tax liability?

What is the client’s ATR?

What is the client’s ETR?

What is the MTR if the client earns an additional $1 of taxable income?

**2)** Using the facts from example (1), assume the client earns an additional $25,000 in income, $20,000 of which is taxable.

What is the MTR?

**3)** Using the original facts (example 1), now assume that instead of an increase in income, your client has an unexpected deduction that reduces her taxable income by $10,000.

What is the client’s new MTR?