

Chapter 1

Introduction to Federal Taxation and Understanding the Federal Tax Law

TRUE-FALSE QUESTIONS—CHAPTER 1

1. The majority of dollars collected by the U.S. government come by way of corporate taxation.
2. Prior to the Sixteenth Amendment direct taxes were illegal.
3. All U.S. taxes are based on an individual's income.
4. Customs taxes are imposed on exports to protect our natural resources from leaving the country. Also, some states tax natural resources, and some countries restrict and tax the amount of natural resources leaving their country.
5. Property taxes are a major source of revenue for the federal government.
6. The value-added tax is an example of an indirect tax that is similar to sales taxes.
7. The U.S. federal tax system is a self-assessment tax collection system.
8. The Sixteenth Amendment gave Congress the right to tax all income from whatever source derived.
9. The current tax system can be classified as "pay-as-you-go."
10. Since 1913, changes in the tax laws have always increased individual tax rates, never decreased them.
11. Tax avoidance is discouraged as being anti-American.
12. A regressive tax structure is one in which the average tax rate increases as the tax base decreases.
13. Another name for a flat tax is a progressive tax.
14. Stamps purchased to enable postal delivery services are an example of user fees.
15. An equitable tax system is a fair tax system.
16. The Sixteenth Amendment to the U.S. Constitution gives Congress the power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.
17. Most state and local property taxes use a single tax rate, making them a type of ad valorem tax.
18. A system whereby income taxes are withheld systematically from current wages can be referred to as a "pay-as-you-go" system.
19. Tax avoidance can be the sole business purpose for a transaction.
20. Tax avoidance should be at the top of every taxpayer's list for tax planning.
21. The doctrine of separation of powers refers to the relationship between the Internal Revenue Service and the Treasury Department.
22. Revenue legislation begins in the Senate.
23. All relevant taxes, including state, local and foreign income taxes, as well as employment and other taxes, must be taken into consideration when computing the tax effects of any proposed transaction.
24. Once taxable income has been calculated, the taxpayer's regular tax liability is computed using the progressive income tax rates; however, different tax rates apply to corporate and individual taxpayers.
25. A partnership is taxed as a separate entity.
26. Flow-through entities do not pay tax on taxable income, so it is not necessary for them to keep track of their gross income.
27. Upon examination of a tax return, the IRS has the authority to impose additional taxes and penalties.

MULTIPLE CHOICE QUESTIONS—CHAPTER 1

28. To be guilty of tax evasion, you must:
 - a. Try to maximize profits.
 - b. Try to minimize your tax liability.
 - c. Arrange your affairs so as to keep your taxes as low as possible.
 - d. Refuse to disclose a tax liability based on a completed transaction.
29. The major source of federal tax revenue is:
 - a. Corporate income tax
 - b. Individual income tax
 - c. Excise tax
 - d. Estate tax
30. Since 1980, the group of taxpayers whose tax burden has increased the most is:
 - a. Individuals
 - b. Corporations
 - c. Trusts and estates
 - d. None of the above
31. The most popular form of doing business in the United States is:
 - a. Corporate form
 - b. Partnership form
 - c. Single proprietorship
 - d. S corporation
32. The IRS levies penalties for which of the following:
 - a. Bouncing checks
 - b. Fraud
 - c. Late filing
 - d. All of the above
33. The ultimate source of power to tax resides with the:
 - a. President
 - b. House Ways and Means Committee
 - c. Senate Finance Committee
 - d. Constitution
34. A main source of revenues for most local governments is:
 - a. payroll taxes.
 - b. property taxes.
 - c. income taxes.
 - d. None of the above.
35. The rate of tax that a taxpayer pays on the last dollar of income is known as:
 - a. the marginal tax rate.
 - b. the average tax rate.
 - c. the effective tax rate.
 - d. none of the above.
36. The Revenue Reconciliation Act of 1998 imposed the following:
 - a. Raised from two to three the number of statutory rates.
 - b. Lowered the holding period for long-term capital gains from 18 to 12 months.
 - c. Imposed a maximum capital gains rate of 28 percent.
 - d. Reduced spending by \$40 million.

37. Property taxes can be imposed on:
 - a. real estate.
 - b. tangible property.
 - c. intangible property.
 - d. both a and c.
 - e. all of the above.
38. Which notion recognizes that mere appreciation in value does not necessarily mean that the owner has the resources to pay the tax associated with the appreciation:
 - a. cash-on-delivery principle.
 - b. wherewithal-to-pay concept.
 - c. capital recovery doctrine.
 - d. None of the above.
39. When a transfer of wealth occurs upon a person's death and the tax owed is levied on the recipient, it is called:
 - a. estate tax.
 - b. inheritance tax.
 - c. gift tax.
 - d. none of the above.
40. The art of using existing tax laws to pay the least amount of tax legally possible is known as:
 - a. tax evasion.
 - b. tax avoidance.
 - c. tax elusion.
 - d. None of the above.
41. The Sixteenth Amendment to the U.S. Constitution affects:
 - a. direct taxes.
 - b. indirect taxes.
 - c. both (a) and (b).
 - d. neither (a) nor (b).
42. The sections of the Internal Revenue Code are amended
 - a. by the Joint Committee on Taxation.
 - b. by the House of Representatives.
 - c. by public laws.
 - d. by the Senate.
43. An exaction for revenue, such as the income tax, supports government functions like which of the following:
 - a. provide for the general welfare.
 - b. provide for the common defense.
 - c. pay national debts.
 - d. all of the above.

SUPPLEMENTARY PROBLEMS—CHAPTER 1

44. If the current U.S. deficit remains high, what options are available to Congress and the President?
45. What is meant by the phrase “pay-as-you-go” tax system?
46. If taxpayers believe that tax rates will increase in the future, what tax planning steps might they take to minimize their tax bills?
47. Some people maintain that corporations should not pay taxes. Explain.

ANSWERS TO TRUE-FALSE QUESTIONS—CHAPTER 1

1. False. Individuals contribute the majority of dollars.
2. True.
3. False. No, there are also excise and customs taxes. The income tax is but one tax that is used.
4. False. On imports.
5. False. For local governments.
6. True.
7. True.
8. True.
9. True.
10. False. No, several tax reform acts decreased tax rates.
11. False. Perfectly legal and encouraged by our society.
12. False. A regressive tax structure is one where the average tax rate decreases as the tax base increases.
13. False. A flat tax is a proportional tax.
14. True.
15. True.
16. True.
17. False. This would not be an example of an ad valorem tax but a proportional tax.
18. True.
19. False. Every transaction must have a business purpose. Tax avoidance is not a business purpose.
20. True.
21. False. This doctrine refers to the executive, legislative, and judicial branches of government.
22. False. It begins in the House of Representatives.
23. True.
24. True.
25. False. A partnership is not taxed.
26. False. They are conduits and the income they generate is taxed to the individual partners.
27. True.

ANSWERS TO MULTIPLE CHOICE QUESTIONS—CHAPTER 1

- 28. d. Once a transaction is completed, it must be disclosed.
- 29. b. The U.S. government collects slightly more than 40% of its revenue from the individual income tax.
- 30. a. Individuals have increased by 183% their tax payments to the federal government.
- 31. c. By far, the most popular form of business enterprise is the single proprietorship.
- 32. d. All items listed would have the IRS impose penalties.
- 33. d. Constitution.
- 34. b. Property taxes are the main source of revenues for local governments.
- 35. a. The marginal tax rate.
- 36. b. The holding period for the lowest capital gain rate has been reduced from 18 to 12 months.
- 37. e. Property taxes can be imposed on real estate, tangible and intangible property.
- 38. b. The appreciation in value of an asset does not mean the taxpayer has the wherewithal-to-pay tax on the appreciation.
- 39. b. The recipient pays the inheritance tax.
- 40. b. Tax planning is using existing laws to pay the least amount of tax.
- 41. a. The Sixteenth Amendment to the Constitution affects direct taxes.
- 42. c. The IRC is amended by Acts of Congress.
- 43. d. All the items listed are supported by general tax revenues.

ANSWERS TO SUPPLEMENTARY PROBLEMS—CHAPTER 1

44. Congress and the President might raise taxes or they will have to cut expenses. Another option is to limit exports. Currently, the pressure is growing in Congress for a tax hike.
45. Since 1943, the federal government collects most of its taxes by means of withholding and estimated taxes. The IRS has recently reported that 6 times as many individual taxpayers file for refunds as have tax due at year-end.
46. Try to recognize income now while the tax rates are low and then defer expenses until rates increase.
47. Since corporations are owned by individuals and they pay taxes, ultimately all corporate profits are taxed. Therefore, some people maintain taxing corporations hinders capital formation.

DIFFICULTY LEVEL RATINGS—CHAPTER 1

The following table denotes the relative difficulty level of each question. Teachers may wish to organize test questions based on the difficulty level of the particular class.

True-False Question Ratings

1. Easy
2. Easy
3. Easy
4. Easy
5. Easy
6. Easy
7. Easy
8. Easy
9. Easy
10. Easy
11. Easy
12. Easy
13. Easy
14. Easy
15. Easy
16. Moderate
17. Moderate
18. Moderate
19. Moderate
20. Moderate
21. Easy
22. Moderate
23. Moderate
24. Easy
25. Easy
26. Easy
27. Moderate

Multiple Choice Question Ratings

28. Easy
29. Easy
30. Easy
31. Easy
32. Easy
33. Easy
34. Easy
35. Easy
36. Moderate
37. Easy
38. Easy
39. Moderate
40. Easy
41. Easy
42. Easy
43. Moderate

Supplementary Problem Ratings

44. Moderate
45. Easy
46. Moderate
47. Moderate