Chapter 1

An Introduction to Taxation and Understanding the Federal Tax Law

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LEARNING OBJECTIVES (1 of 2)

LO.1 - Explain the importance of taxation and apply methods for studying this topic.

LO.2 - Describe some of the history and trends of the Federal income tax.

LO.3 - Describe and apply principles and terminology relevant to the design of a tax system.

LO.4 - Identify the different taxes imposed in the United States at the Federal, state, and local levels.

LO.5 - Explain the administration of the tax law, including the audit process utilized by the IRS.

LEARNING OBJECTIVES (2 of 2)

LO.6 - Evaluate some of the ethical guidelines involved in tax practice.

LO.7 - Classify tax rules based on their possible economic, social, equity, and political reasons for inclusion in a particular tax system.

LO.8 - Explain the role played by the IRS and the courts in the evolution of the Federal tax system.

The Big Picture (1 of 5)

- Travis and Amy Carter are married and have 2 children
  - April (age 17) and
  - Martin (age 18)
- Travis is a mining engineer; Amy is a registered nurse
- After several years with a mining corporation, Travis established a consulting practice that involves considerable amount of travel
- The Carters live only a few blocks from Ernest and Mary Walker, Amy Carter's parents
  - The Walkers are retired and live on interest, dividends, and Social Security benefits

The Big Picture (2 of 5)

- Various developments occurred during the year with possible tax ramifications
  - The *ad valorem* property taxes on the Carters' residence increased, whereas those on the Walkers' residence decreased
  - When Travis registers an automobile purchased last year in another state, he is required to pay a sales tax to his home state

The Big Picture (3 of 5)

- Various developments occurred during the year with possible tax ramifications
  - As an anniversary present, the Carters gave the Walkers a recreational vehicle (RV)
  - When Travis made a consulting trip to Chicago, the client withheld Illinois state income tax from the payment made to Travis for his services

The Big Picture (4 of 5)

- Various developments occurred during the year with possible tax ramifications
    - Travis employs his children to draft blueprints and prepare scale models for use in his work
        - Both April and Martin have had training in drafting and topography
    - Early in the year, the Carters are audited by the state on an income tax return filed a few years ago
        - Later in the year, they are audited by the IRS on a Form 1040 they filed for the same year
        - In each case, a tax deficiency and interest were assessed

The Big Picture (5 of 5)

- Various developments occurred during the year with possible tax ramifications
  - The Walkers are audited by the IRS
    - Unlike the Carters, they did not have to deal with an agent, but settled the matter by mail
- Explain these developments and resolve the issues raised. Read the chapter and formulate your response

Approaching the Study of Taxation

- What is taxation?
  - Meaning from two famous quotes:
    - “Taxes are what we pay for civilized society.”
    - “Nothing is certain, except death and taxes.”
  - Taxes produce revenue for government operations
  - Can also be used to influence the behavior of individuals, businesses, nonprofit entities and even governments

The Relevance of Taxation to Accounting and Finance Professionals

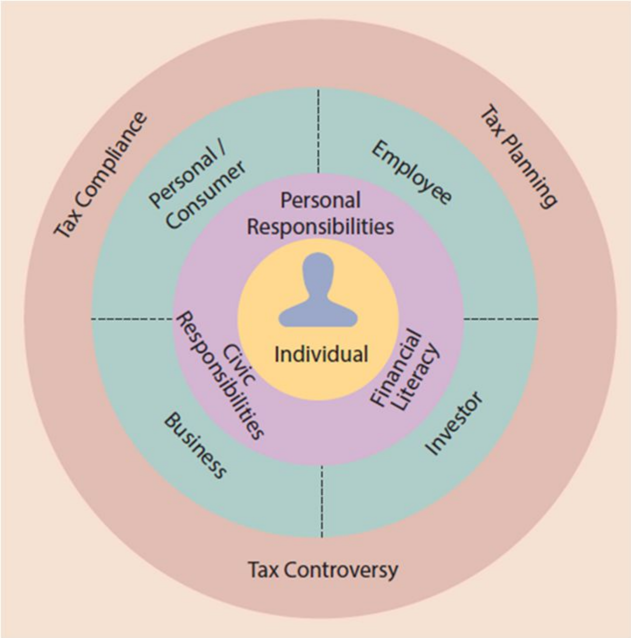
- Key tax functions
  - Compliance
  - Planning
  - Financial reporting
  - Controversy
  - Cash management
  - Data analysis

How to Study Taxation

- Goal – Recognize issues or transactions that have tax implications
- Find the outcome through research
- Focus on understanding the rules
  - When applicable
  - Why designed in a particular way
  - When relevant
  - For business tax rules – how do they compare to financial reporting treatment

Individuals and Taxes

Use this diagram to consider where in the circle various rules for individuals fit



History of U.S. Taxation (1 of 2)

- Prior to the 1900s, income tax financed Civil War
    - 1861 – First Federal individual income tax enacted
        - Repealed after the Civil War ended
    - 1894 – New Federal individual income tax enacted
        - Opponents were prepared to challenge its constitutionality

History of Taxation (2 of 2)

- Other important events
  - 1909 – First Federal corporate income tax enacted
  - 1913 – Sixteenth Amendment ratified
    - Sanctioned both Federal individual and corporate income taxes and neutralized continuing effect of the Pollock decision.

Federal Tax Revenues—2020

Tax Revenue Sources	Percentage
Individual income taxes	51%
Corporate income taxes	8
Payroll taxes	36
Excise taxes	3
Custom duties	<2
Estate and gift taxes	<1
Total	100%

Tax System Design (1 of 2)

- Legal foundation
  - U.S. Constitution
    - Article I, Section 8 – gives taxing power to Congress
    - Sixteenth Amendment – allows for an income tax

Tax System Design (2 of 2)

Tax base → X → Tax rate → = → Tax liability

- Tax base – amount to which the tax rate is applied
    - In case of the Federal income tax, the tax base is taxable income
- Tax rates – applied to the tax base to determine the tax liability
    - May be proportional or progressive

Tax Principles

- Adam Smith identified the following canons (or principles) of taxation, which are still considered when evaluating tax structures:
  - Equity
  - Certainty
  - Convenience of payment
  - Economy in collection

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AICPA Guiding Principles of Good Tax Policy

a) Equity and Fairness
b) Certainty
c) Convenience of Payment
d) Effective Tax Administration
e) Information Security
f) Simplicity
g) Neutrality
h) Economic Growth and Efficiency
i) Transparency and Visibility
j) Minimum Tax Gap
k) Accountability to Taxpayers
l) Appropriate Government Revenues

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Major Types of Taxes

- Property taxes (*ad valorem*)
- Transaction taxes
- Taxes on transfers at death
- Gift taxes
- Income taxes
- Employment taxes
- Other U.S. taxes
- Proposed U.S. taxes

Property Taxes (ad valorem)

- Based on the value of the asset
  - Essentially, a tax on wealth, or capital
- Generally imposed on realty and personalty
  - Realty: land and buildings
    - Example: residence, office building, etc
  - Personalty: other than land and buildings
    - Example: home furniture, surgical instruments, etc
- Exclusive jurisdiction of states and their local political subdivisions
- Deductible for Federal income tax purposes

The Big Picture—Ad Valorem Property Taxes

- Return to the facts of The Big Picture
  - Why did the Walkers' taxes decrease but those of the Carters increase?
    - A likely explanation is that one (or both) of the Walkers achieved senior citizen status
    - In the case of the Carters, the assessed value of their property probably increased
      - Perhaps they made significant home improvements (example, kitchen/bathroom renovation or addition of a deck)

Transaction Taxes

- Federal excise taxes
- State and local excise taxes
- General sales taxes
- Severance taxes

Federal Excise Taxes

- Imposed at the Federal level
- Restricted to specific items
  - Examples: tobacco products, fuel and gasoline sales, air travel
  - Other Federal taxes include:
    - Manufacturer’s excise tax on trucks, trailers, tires, firearms, sporting equipment, and coal and gas guzzler tax on automobiles
    - Alcohol taxes
    - Miscellaneous taxes (e.g., tax on wagering, tax on investment income of certain private colleges and universities)

State and Local Excise Taxes

- Imposed at the state and local levels
- Restricted to specific items
    - Examples: tobacco products, gasoline sales, liquor
    - Two types of excise taxes at the local level have recently become increasingly popular
        - Hotel occupancy tax
        - Rental car surcharge
    - Tax is levied on visitors who cannot vote and often used to fund special projects that generate civic pride

General Sales Taxes

- Currently in jurisdiction of states and localities
- States that impose sales taxes also charge a use tax on items purchased in other states but used in their jurisdiction
- States without sales or use taxes are Alaska, Delaware, Montana, New Hampshire, and Oregon

The Big Picture—Use Tax

- Return to The Big Picture
  - The payment Travis made when he registered the car is probably a use tax
    - When the car was purchased in another state, likely no (or a lesser) sales tax was levied
    - The current payment makes up for the amount of sales tax he would have paid had the car been purchased in his home state

Severance Taxes

- Tax on natural resources extracted
  - Important revenue source for states rich in natural resources
    - Example: oil, gas, iron ore, or coal etc.

Taxes on Transfers at Death (1 of 2)

- Tax on the right to transfer property or to receive property upon the death of the owner
  - If imposed on right to pass property at death
    - Classified as an estate tax
  - If imposed on right to receive property from a decedent
    - Classified as an inheritance tax

Taxes on Transfers at Death (2 of 2)

- The value of the property transferred provides the base for determining the amount of the death tax
- The Federal government imposes only an estate tax
- Some state governments levy inheritance taxes, estate taxes, or both
- Some state governments levy neither tax (for example, Florida and Texas)

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Federal Estate Tax (1 of 3)

- Federal estate tax is on the right to pass property to heirs
    - Gross estate includes FMV of property decedent owned at time of death
        - Also includes property interests, such as life insurance proceeds paid to the estate

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Federal Estate Tax (2 of 3)

- Property included in the gross estate is valued on either:
  - Date of death, or
  - If elected, the alternate valuation date
    - Generally 6 months after date of death
- Certain deductions and credits allowed in arriving at the taxable estate
  - Examples - marital deduction, funeral and administration expenses, certain taxes, debts of the decedent, casualty losses incurred during the administration of the estate, and transfers to charitable organizations

Federal Estate Tax (3 of 3)

- Marital deduction is available for amounts actually passing to a surviving spouse (a widow or widower)

Unified Transfer Tax Credit

- Unified transfer tax credit reduces or eliminates the estate tax liability for certain estates
- For 2020, the credits exempt tax base up to $11,580,000

State Taxes on Transfers at Death

- State taxes on transfers at death may be estate tax, inheritance tax, or both
  - Inheritance tax is on the right to receive property from a decedent
  - Tax is generally based on the relationship of the heir to the decedent
    - The more closely related, the lower the rates imposed and/or the greater the exemption allowed

The Federal Gift Tax (1 of 3)

- Tax on the property transfers during the person's life and not at death
- Taxable gift = FMV of the gift less annual exclusion per donee less marital deduction (if applicable)
- In 2020, each donor is allowed an annual exclusion of $15,000 for each donee (the same as in 2019)

The Federal Gift Tax (2 of 3)

- Married couple can make a special election to split gifts
  - Allows one-half of the gift made by the donor-spouse to a third party to be treated as being made by the non-donor-spouse (gift splitting)
  - Effectively allows the annual exclusion to double

The Federal Gift Tax (3 of 3)

- The unified transfer tax credit is available for gifts (as well as the estate tax)
- The credit for 2020 is $4,577,800
    - Covers taxable gifts up to $11,580,000
- The credit for 2019 is $4,505,800
    - Covers taxable gifts up to $11,400,000
- There is only one unified transfer tax credit
    - It applies to both taxable gifts and the Federal estate tax
    - Once the unified transfer tax credit has been used up for Federal gift tax purposes, any transfers at death will be subject to Federal estate tax

The Big Picture—Gift Tax

- Return to The Big Picture
  - The value of the RV is not stated, but it probably exceeds the annual exclusion allowed—$60,000 for two donees (the Walkers) from two donors (the Carters)
    - Thus, a taxable gift results, and a Form 709 (Gift Tax Return) must be filed
    - Whether any gift tax is due depends on
      - Past taxable gifts the Carters have made and
      - Amount of their unified transfer tax credit still available

Income Taxes

- Imposed at the Federal, most states, and some local governments
  - Income taxes generally are imposed on individuals, corporations, and certain fiduciaries (estates and trusts)
- Most jurisdictions attempt to ensure tax collection by requiring pay-as-you-go procedures, including
  - Withholding requirements for employees
  - Estimated tax payments for all taxpayers

Formula for Federal Income Tax on Individuals

Income (broadly defined)	$xx,xxx
Less: Exclusions (income that is not subject to tax)	(x,xxx)
Gross income (income that is subject to tax)	$xx,xxx
Less: Certain deductions (usually referred to as deductions *for* adjusted gross income)	(x,xxx)
Adjusted gross income	$xx,xxx
Less: The greater of:	
Certain personal and investment deductions (referred to as *itemized deductions*)	
or	
The standard deduction (including any additional standard deduction)	(x,xxx)
Less: Personal and dependency exemptions*	(x,xxx)
Deduction for qualified business income**	(x,xxx)
Taxable income	$xx,xxx
Tax on taxable income (see the Tax Tables and Tax Rate Schedules in Appendix A)	$ x,xxx
Less: Tax credits (including Federal income tax withheld and other prepayments of Federal income taxes)	(xxx)
Tax due (or refund)	$ xxx

*Exemption deductions are not allowed from 2018 through 2025.
**Only applies from 2018 through 2025.

Corporate Income Tax

- Corporation's Taxable Income = Gross Income − Deductions
  - Uses a flat tax rate of 21 percent
  - Does not include the computation of adjusted gross income
  - Does not provide for the standard deduction or the deduction for qualified business income

State Income Tax (1 of 4)

- Almost all states impose an income tax on individuals
- Some characteristics of state income taxes are:
  - With few exceptions, all states require some form of withholding procedures
  - Most states use the income determination made for Federal income tax purposes as the tax base
    - Referred to as the “piggyback” approach to state income taxation

State Income Tax (2 of 4)

- Some characteristics of state income taxes are:
  - Some states "decouple" from selected Federal tax legislation enacted by Congress
    - State may not be able to afford the loss of revenue resulting from such legislation
  - Because of tie-ins to the Federal return, states may be notified of changes made by the IRS upon audit of a Federal return (or vice versa)
  - Most states allow a deduction for personal and dependency exemptions

State Income Tax (3 of 4)

- Some characteristics of state income taxes are:
  - Many state income tax returns provide checkoff boxes for donations to various cause
  - The objective of most states is to tax the income of residents and those who conduct business in the state
  - Most states allow their residents some form of credit for income taxes paid to other states

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State Income Tax (4 of 4)

- Some characteristics of state income taxes are:
  - The due date for filing generally is the same as for Federal income tax (usually April 15 for calendar year taxpayers)
  - Some states have occasionally instituted amnesty programs that allow taxpayers to pay back taxes (and interest) on unreported income with no (or reduced) penalty
  - In some states, state income tax returns include a separate line for reporting any use tax that is due

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The Big Picture—State Income Tax-Double Taxation

- Return to The Big Picture
  - Travis will need to review the state income tax laws in each states he has clients to determine if he is subject to that state's tax on his consulting income earned in that state.
  - If the income is subject to tax in another state as well as his home state, the home state might provide a credit to negate the double taxation

Local Income Taxes

- Cities imposing an income tax include Baltimore, Cincinnati, Cleveland, Detroit, Kansas City (Missouri), New York, Philadelphia, and St. Louis
    - The application of a city income tax is not limited to local residents

Employment Taxes (1 of 4)

- Imposed on employers and employees
- FICA taxes
    - Two components
        - The Social Security rate is 6.2% in 2020 on a maximum of $137,700 of wages ($ 132,900 for 2019)
        - The Medicare rate is 1.45% on all wages
    - A spouse employed by another spouse is subject to FICA
    - Children under the age of 18 who are employed in parent's unincorporated trade or business are exempt from FICA

Employment Taxes (2 of 4)

- FICA taxes
  - The Affordable Care Act (ObamaCare) imposes an additional 0.9% tax on earned income above $200,000 (single filers) or $250,000 (married filing jointly)
    - An employer does not have to match the employees' 0.9%
  - A 3.8% tax is imposed on net investment income (example - rents, taxable interest, dividends, and capital gains)
    - Applies when modified AGI exceeds $200,000 (single filers) or $250,000 (married filing jointly)

Employment Taxes (3 of 4)

- Self-employment tax
  - Sole proprietors and independent contractors may also be subject to Social Security taxes
    - Rates are twice that applies to an employee
      - Generally, 12.4% for Social Security and 2.9% for Medicare
    - The social security tax is imposed on net self-employment income up to a base amount of $137,700 for 2020 and $ 132,900 for 2019
    - The additional 0.9% Medicare tax also covers situations involving high net income from self-employment

Employment Taxes (4 of 4)

- FUTA (unemployment) taxes
  - Provide funds for state to administer unemployment benefits
  - In 2020, rate is 6% on first $7,000 of wages paid to each employee
  - Administered jointly by Federal and state government
    - Credit is allowed (up to 5.4%) for FUTA paid to the state
    - Thus, the amount required to be paid to the Federal government could be as low as 0.6% (6.0% − 5.4%)
  - Tax is paid by employer
    - Few states, however, levy a special tax on employees to provide either disability benefits or supplement unemployment compensation or both

The Big Picture—Social Security Tax

- Return to The Big Picture
  - Presuming April and Martin perform meaningful services for Travis, they are legitimate employees
    - April is not subject to Social Security tax because she is under the age of 18
    - However, Martin is age 18 and needs to be covered
    - Furthermore, Amy Carter is now working at a medical clinic and will also be subject to Social Security tax
    - Travis, as an independent contractor, is subject to self-employment tax

Other U.S. Taxes

- Federal customs duties
  - Tariffs on certain imported goods
- Franchise taxes
  - Levied on corporation for the right to do business in the state
- Occupational fees
  - Applicable to various trades or businesses
    - Example: liquor store license, taxicab permit, fee to practice a profession such as law, medicine or accounting

The Big Picture—Occupational Fees

- Return to The Big Picture
  - Although the facts do not mention the matter, both Travis and Amy might owe occupation or license fees—Travis for engineering and Amy for nursing

Proposed U.S. Taxes (1 of 3)

- Flat tax
  - Is a form of consumption tax
  - Flat 19% tax on all businesses (corporate or otherwise)
  - Flat 19% tax on wages and pension benefits above an exemption of $25,500
- National sales tax (Fair tax)
  - Levied on the final sale of goods and services (at approximately 23%)
    - Provides monthly rebate to offset a portion of sales tax paid by individuals

Proposed U.S. Taxes (2 of 3)

- Value added tax
  - Imposed on the value added by each party in a production cycle
    - The system of credit results in VAT ultimately only being paid by the final consumer
  - Most countries use this (in addition to income tax)
- Carbon tax
  - Aims to help reduce carbon emissions (i.e., greenhouse gases)

Proposed U.S. Taxes (3 of 3)

- Financial transaction tax
  - Can take many forms
  - Could be imposed on the value of financial instruments purchased (e.g., stocks and bongs)
  - Could be imposed on the value of bank assets

Tax Administration (1 of 5)

- Internal Revenue Service (I R S)
  - Part of the Department of the Treasury and is responsible for enforcing the Federal tax laws
  - The Commissioner of Internal Revenue is appointed by the President with the advice and consent of the Senate
  - The Commissioner is responsible for establishing policy and supervising the activities of the IRS

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Tax Administration (2 of 5)

- The Audit Process
  - Only a small number of returns are audited each year using mathematical formulas and statistical sampling
    - To update selection criteria, the IRS selects a cross section of returns, which are subject to various degrees of inspection
  - IRS pays rewards to persons who provide information leading to discovery of those who violate tax laws
    - The rewards may not exceed 30% of taxes, fines, and penalties recovered

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Tax Administration (3 of 5)

- Types of audits:
  - Correspondence audit
  - Office audit
    - Usually restricted in scope and conducted in IRS offices
  - Field audit
    - Involves examination of numerous items reported on the return and is conducted at the taxpayer’s location or that of the taxpayer's representative

Tax Administration (4 of 5)

- At the end of an audit, a Revenue Agent's Report (RAR) is issued summarizing the findings that can result in a:
    - Refund (tax was overpaid)
    - Deficiency (tax was underpaid), or
    - No change (tax was correct) finding
- During the course, if a special agent accompanies the regular auditor:
    - The IRS suspects fraud
    - The taxpayer should retain competent legal counsel

Tax Administration (5 of 5)

- If an audit results in an assessment of additional tax
  - Taxpayer may request an appeal
    - An appeal is available through the Appeals Division of the IRS
      - Appeals Division is authorized to settle all disputes based on the hazards of litigation (i.e., probability of favorable resolution, if litigated)
  - If a satisfactory settlement is not reached on administrative appeal, the taxpayer can litigate in:
    - Tax Court
    - Federal District Court, or
    - Court of Federal Claims
  - Litigation is recommended only as a last resort because of:
    - Legal costs involved
    - Uncertainty of the final outcome

The Big Picture—IRS Audit

- Return to The Big Picture
  - The audit of the Walkers by the IRS obviously was a correspondence type
    - The reason for the audit was probably a minor oversight, such as the omission of some interest or dividend income
  - The audit of the Carters, however, was more serious—probably a field or office type
    - Because the Federal audit followed a state audit that was productive (that is, led to the assessment of a deficiency), there may have been an exchange of information between the two taxing authorities

Statute of Limitations (1 of 3)

- Statute of limitations is a provision that requires any lawsuit to be brought within a reasonable period of time
  - Found at the state and Federal levels, such statutes cover the multitude of both civil and criminal suits
- For Federal income tax purposes, the two categories involved are:
  - The assessment of additional tax deficiencies by the IRS and
  - Claims for refunds by taxpayers

Statute of Limitations (2 of 3)

- For a deficiency assessment by IRS
  - Generally 3 years from the later of the due date or the filing date of the return
  - For material (more than 25%) omissions of gross income, time period is 6 years
  - No statute if no return is filed or fraudulent return is filed

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Statute of Limitations (3 of 3)

- For a refund claim by taxpayer
  - Generally 3 years from date return was filed or 2 years from date tax was paid, whichever is later
    - Income tax returns filed early are deemed to have been filed on the date the return was due

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Interest and Penalties (1 of 3)

- Interest accrues on the taxes due starting from the due date of the return, and interest is paid on refunds if not received within 45 days of when the return was filed
  - Rate for January 1 to March 31 of 2020 is 5%
  - IRS publishes rate quarterly

Interest and Penalties (2 of 3)

- Tax law provides various penalties for lack of compliance including penalties for:
    - Failure to file a tax return by the due date
        - Penalty is 5% per month up to a max of 25% on the amount of tax shown as due on the return
            - Any fraction of a month counts as a full month
    - Failure to pay the tax
        - Penalty is 0.5% per month up to a max of 25%
    - Negligence penalty (up to 20%) may also apply to underpayment for disregard of rules without intend to defraud

Interest and Penalties (3 of 3)

- Various penalties may be imposed in the case of fraud
  - In the case of civil fraud
    - Penalty is 75% of the underpayment attributable to fraud
  - In the case of criminal fraud
    - Penalties can be include large fines as well as prison sentences
  - Negligence penalty is not imposed when the fraud penalty applies

Tax Practice (1 of 4)

- Area of tax practice is largely unregulated
  - Members of professions must follow certain ethical standards (example, public accounting or law)
  - Various penalties may be imposed upon preparers of Federal tax returns who violate identified acts and procedures

Tax Practice (2 of 4)

- Ethical guidelines issued by American Institute of CPAs (AICPA)
  - Do not take questionable positions on client's tax return in hope of it not being audited by IRS
  - Client's estimates may be used if reasonable under the circumstances
  - Try to answer every question on the tax return (even if disadvantageous to client)
  - Upon discovery of an error in prior year tax return, advise client to correct it
    - Do not inform the IRS of the error

Tax Practice (3 of 4)

- Statutory penalties may be levied on tax return preparers for:
  - Procedural matters including failure to:
    - Provide copy of return to taxpayer
    - Endorsing a taxpayer's refund check
    - Sign the return as a preparer
    - Furnish identification number
    - Keep copies of returns
    - Maintain a client list

Tax Practice (4 of 4)

- Statutory penalties may be levied on tax return preparers for:
  - Understatement of tax liability based on a position that lacks substantial authority
  - Willful attempts to understate tax
  - Failure to exercise due diligence in determining eligibility for, or the amount of, the earned income tax credit, the child tax, or the American opportunity tax credit

Understanding the Federal Tax Law (1 of 3)

- The Federal tax law is the vehicle for accomplishing objectives of the nation such as
  - Raising revenue – key factor in structuring a tax system
  - Economic considerations – increasingly important objective is to regulate the economy and encourage certain activities, certain industries and small businesses

Understanding the Federal Tax Law (2 of 3)

- Federal tax objectives
  - Social considerations – encourage socially desirable behavior that provides benefits that government might otherwise provide
  - Equity considerations – equity within the tax laws (example: wherewithal to pay concept) and not necessarily equity across taxpayers

Understanding the Federal Tax Law (3 of 3)

- Federal tax objectives
    - Political considerations – a large segment of the tax law is created through a political process; thus, compromises and special interest dealings occur
    - Influence of IRS – many provisions are meant to aid the IRS in the collection of taxes
    - Influence of courts – influence tax law and sometimes cause it to change

Refocus on The Big Picture (1 of 3)

- The explanation given for the difference in the ad valorem taxes – the Carters' increase and the Walkers' decrease – seems reasonable
    - It is not likely that the Carters' increase was due to a general upward assessment in valuation, because the Walkers' taxes on their residence (located nearby) dropped
    - More business use of the Carters' residence (presuming Travis conducts his consulting practice from his home) might be responsible for the increase, but capital improvements appear to be a more likely cause

Refocus on The Big Picture (2 of 3)

- Imposition of the use tax when Travis registered the new automobile is one way a state can preclude the avoidance of its sales tax
- When gifts between family members are material (e.g., an RV) and exceed the annual exclusion, a gift tax return needs to be filed
    - Even though no gift tax is due because of the unified transfer tax credit, filing a return starts the running of the statute of limitations

Refocus on The Big Picture (3 of 3)

- The Carters must recognize that some of their income is subject to income taxes in two states and take advantage of whatever relief is available to mitigate the result
- Employment within and by the family group (e.g., children, other relatives, domestics) has become a priority item in the enforcement of Social Security tax and income tax withholdings
    - The Carters should be aware of the need to cover their son, Martin
- Because of the double audit (i.e., both state and Federal) and the deficiency assessed, the Carters need to make sure that future returns do not contain similar errors
    - Taxpayers with prior deficiencies are among those whose returns may be selected for audit