

2012 EDITION

# Concepts in Federal Taxation



Murphy & Higgins



2012 EDITION

# *Concepts* in Federal Taxation

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## PREFACE

Many students view the introductory tax course as an impossible task of learning the Internal Revenue Code. The Code, which is the statutory basis of the federal income tax system, is complex and can be intimidating to students and tax professionals. However, we feel strongly that tax education can be interesting and, with the straightforward yet complete coverage in *Concepts in Federal Taxation*, offer a refreshing, thought-provoking textbook. Designed specifically for the introductory tax course, this book is rigorous enough for students specializing in taxation, but it will not intimidate those who plan to pursue other areas of accounting and business.

### Conceptual Approach

There are two ways to look at the rules that govern federal taxation: the technical approach and the conceptual approach. The traditional “technical approach” looks at the reams of tax authority as thousands of specific and distinct code sections, regulations, exceptions, and qualifications. This approach treats income tax in such great depth that the first-time tax student has difficulty understanding the myriad rules, exceptions to those general rules, and exceptions to the exceptions. As a result, students tend to view the first tax course as a long string of unrelated topics that they must memorize to pass the course.

The “conceptual approach” presents taxation as a small number of unifying concepts—principles that apply in the application of specific tax rules and authorities. These concepts define taxation. An analogy can be made to mathematical operations: by understanding how multiplication works and memorizing the nine times tables, people learn to multiply any number by any other number. One can multiply 23 by 25 correctly without having memorized a times table that includes that pair of numbers. Likewise, knowing the underlying concepts that shape tax law allows students to understand a wide range of tax law without committing every line of the Internal Revenue Code to memory.

### Organization

Instead of focusing on the individual aspects of taxation, this textbook emphasizes transactions that are common to all tax entities. This allows the text to focus more on the overall scheme of taxation (What is income? What is a deduction? and so on) with individual tax return preparation a secondary issue. As a result, Chapter 1 introduces the individual tax formula and briefly discusses the “for” versus “from” adjusted gross income distinction that is unique to individuals, but the mechanics of the individual tax calculation are not discussed in detail until Chapter 8. Furthermore, itemized deductions are not accorded the traditional in-depth treatment. Again, the focus is on the more common itemized deductions, and elaborate technical detail is omitted for the more unusual items.

The text is organized into the following six parts:

- **Part I: Conceptual Foundations of the Tax Law**
  - **Chapter 1** provides an overview of the tax system, briefly discusses other types of taxes, outlines the general income tax calculation, discusses the nature of tax planning, and introduces ethical considerations of tax practice.
  - **Chapter 2** develops the conceptual framework and uses it to explain the operation of the tax system in general. Each subsequent chapter begins with a brief review of the concepts discussed in Chapter 2.
- **Part II: Gross Income**
  - **Chapter 3** classifies various sources of income and explains the common problems encountered within each income classification. Its overview of property transactions differentiates the taxation of capital gains and losses from other sources of

## Fundamental Structure