

SELECTING APPROPRIATE TAX TOPICS FOR COVERAGE IN A PRINCIPLES OF ACCOUNTING COURSE

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INTRODUCTION

Should students with a major (or even a minor) in business, be exposed to the basics of the tax structure that drives most business (and even personal) decisions? Should business students be expected to know the basics about their own personal responsibilities to the federal (and possibly state) tax system? If so, where in the business curriculum should the topic be covered? Since tax courses are most often housed in the accounting department, the principles of accounting courses that are usually required of all business majors warrant consideration. Consequently, the focus of this paper is on what tax topics would then be included in principles of accounting so that students would receive at least a brief but critical exposure to the tax requirements of modern society.

OVERVIEW OF TAXES

A few students, especially non-traditional students, may have had an in-depth exposure to taxes. However, students in the traditional 18-to-24-years-old age range sometimes hardly know the basics. For example, two recent questions I have encountered from students are: 1) I had income tax withheld, and my friend said I could file and get it back, but I don't think I can because on my first job a couple of years ago, I asked about social security taxes that were withheld and was told that I couldn't get that back until I was 67, and 2) Where on my 1040A do I deduct my Roth IRA? So, as can be seen, future business graduates need to know more about tax basics. Where to start? First, it is important for students to know that there are several types of taxes. A brief discussion of each of these is a good starting point. Students are often surprised to discover that taxes include a long list of items – income taxes (federal and state), sales taxes, gift and estate taxes, excise taxes (gasoline taxes and taxes on phone calls, cigarettes, alcohol and other items), property taxes, and other taxes such as social security (including employer matching amounts). In fact, anything that a government agency requires that would not otherwise be an expenditure could be considered to be a tax (such as a fee for a sticker to renew a car's license plate). In addition, there are well-hidden taxes. For example, if a student goes to the mall and spends \$50, how much of the \$50 went to pay for hidden taxes such as the gasoline tax on the gasoline in the truck that delivered the goods to the mall, or income taxes paid by workers on wages paid to them by the manufacturers of the products sold in the mall? It does not take long for students to begin to see just how much taxes drive economic and business decisions.

TOPICS TO BE COVERED

Perhaps the most relevant way to present and discuss income tax topics is to pass out copies of an IRS Form 1040 and then go to the IRS Web site (www.irs.gov) and bring up a Form 1040 (or put up an overhead transparency of the form) and then go down the form pointing out relevant information. For example, under Filing Status, mention should be made that the marital status on December 31st determines the marital status for the whole year. Under Exemptions, students need to know that if they can be claimed as a dependent by someone else, they cannot claim themselves. (Students should note that it states "can be claimed," not "could be claimed" – so parents cannot forego the claim in deferral to the child claiming himself or herself.)

The section for Income can be prefaced by a discussion of what constitutes “gross income from whatever source derived.” Then, a careful reading and brief discussion of each item listed under Income would be prudent to alert students to the taxability of these items. Of particular note would be Wages, Salaries, Tips, etc. which should be applicable to all students (and which can include scholarship income in excess of certain amounts) – as well as taxable interest and ordinary and qualified dividends. Also, this would be an appropriate place to show a Schedule C for Business Income or (Loss), a Schedule D for Capital Gains or (Losses), and Schedule E (for rental real estate, royalties, partnerships, S corporations, estates, trusts, etc.). Before leaving this section, a few other important (and interesting) items should also be pointed out – the line item for “other income” can include many items. For example, gambling winnings in excess of losses are taxable and most prizes and awards are taxable. Gifts received, however, are not taxable. Above certain limits, gifts are taxable, but the gift tax is paid by the giver, not the recipient of the gift. Also, currently, anyone can give \$11,000 per year, per person without having to pay a gift tax. However, in all these cases, the money given has to be a gift and not for “services provided,” which would make the “gift” a payment for wages, tips, etc. “Treasure trove” is also considered to be “other income” and is taxable in the year of discovery. Also, the IRS can conduct a “net worth” audit and the taxpayer has to account for the change in net worth. For example, if a taxpayer is determined to have a net worth of \$10,000 and then one year later, the net worth of the taxpayer is determined to be \$250,000, the taxpayer has to explain where the \$240,000 increase came from. Sometimes this is where “treasure trove” shows up – whereby the taxpayer “remembers” that he or she “found” \$240,000 in an old chair or a piano, etc. Nevertheless, the \$240,000 is taxable. Also, illegal income is taxable, as is barter income. These are facts that all college students need to know, especially business students. Also, it is fortunate that once students know this information, it is usually easily remembered by the students and hopefully will serve them well in meeting their tax responsibilities throughout their lives.

Under the Adjusted Gross Income section, it shows that a deduction is allowed for a traditional IRA (which is taxed later when withdrawn). This can then be contrasted to the Roth IRA, which is not allowed as a deduction (but which is not taxed later when withdrawn – nor are the earnings taxed as long as there are no withdrawals within five years). It should be noted that both IRAs serve the purpose of encouraging savings for retirement and are subject to penalties if withdrawn before the age of 59½, unless the reason for withdrawal meets the criteria for exemption of the penalty under the tax statutes.

Under the section for Tax and Credits, Schedule A is referenced which can lead to a discussion about whether to itemize deductions or take the standard deduction. A detailed look at Schedule A helps highlight items such as taxes paid, charitable contributions, mortgage interest expense, and other items that are currently deductible and for which substantiation is required. It should be emphasized that, if itemization is chosen, substantiation of the itemized deductions is crucial. Also, the rules about charitable contributions (and substantiation from the charitable organization for items above certain limits) are very important to know before the return is filed. Also, the difference between a deduction and a credit is a very important concept that can be illustrated here since itemized deductions are put on Schedule A and taken before the tax is calculated (or not used at all if the standard deduction is taken), but tax credits are taken off dollar-for-dollar from the tax owed.

Under Other Taxes, one item of interest is Schedule H, Household Employment Taxes – an item that has proven to be an omission and embarrassment to several politicians over recent years. Also Schedule SE where self-employment taxes are reported is in this section.

Under the Payments section, several important items show up. First, tax withholdings are shown in this section. Students need to know that federal income taxes are a “pay as you go” system and that estimated taxes may need to be paid in some cases. Students may not know that it is not a problem to claim less dependents than entitled, but it is a problem to claim more. So, if a student is married, he or she does not have to put M2 on Form W-4, but can put M0 if the student desires that more taxes be withheld. Also,

anyone can have additional taxes withheld beyond the regular amounts. Students should be reminded, however, that withholding too much is giving the government an “interest-free” loan. However, withholding too little can also cause problems. Another item in the Payments section is the Earned Income Credit (EIC) which is too often overlooked by those entitled to receive the credit. It should be noted that the EIC is payable to the recipient even if no tax is due (sometimes called a negative tax).

EXAMPLES

Once the Form 1040 has been reviewed and discussed in some detail, it is usually a good idea to run some numbers to see how they show up on the forms. It is usually best to start with a straightforward situation of a student with one job and one Form W-2 and perhaps some interest income and a scholarship that is partially taxable. This, of course could be done on a Form 1040A. So, a handout question with the appropriate forms could be distributed to the class and then a few minutes allowed to fill out the form and then the results can be checked in class. Next, a similar problem could be handed out for homework as well as an additional problem that is more advanced – say a married couple, both of whom work, and who have two children. In addition to their wages, the couple could have interest and dividend income. A third case could involve a single individual with a business (Schedule C). These cases could then be reviewed, and their answers checked and discussed at the next class period.

GRADING

One concern is how to grade this information. Since actually attending class and hearing the information is crucial to assimilating this material, this might best be graded in a non-exam way. One way to accomplish this would be to award some points on the next exam (for example 20 points on a 100-point exam) to the tax information. However, the 20 points would be earned by attendance and attention paid to the material covered. Therefore, if a student attends the class session on tax and is there the entire time and pays attention and turns in the problems, the 20 points would be earned. If a student is not there, then some portion of the points (maybe one-half) could be received if the student turns in the problems and a four-to-five-page paper on the tax topics covered.

SUMMARY AND CONCLUSIONS

By focusing on taxes, students should begin to realize how much business and personal decisions are driven by tax consequences. By covering the basics of tax information, business students should receive vital relevant information to help them with their tax calculations and tax responsibilities that will go well beyond the receipt of their business degree. Students need to be reminded that the responsibility for their tax calculations and payments cannot be shifted to someone else, not even to a paid tax preparer. Students also need to be reminded that the tax statutes are ever-changing. Therefore, before making final decisions in which tax considerations play a role, the current statutes (at www.irs.gov) need to be checked.