

# Takin' Care of Business

# #11



CPA... Imagine the possibilities!

**AICPA**

## Learning Activity

**Understanding Taxation:** *Students identify "tax facts" as being economically or socially oriented and, in debate format, present positions that support or challenge a tax law.*

## Learning Objectives

1. Understand that tax laws are enacted and passed by Congress to meet social as well as economic goals.
2. Identify specific tax laws enacted for social purposes or economic purposes, or both.
3. Research and present in the form of a debate a position that supports or challenges a tax law.

## Academic Standard

"Students understand the role of government in an economic system, especially the necessary and desirable role of government in the U.S. economy." (NBEA)

"Students understand the rights and responsibilities of citizens in the U.S. economy, including their role in making decisions through the political process that affect the allocation of limited personal and public resources to meet individual and societal needs and wants." (NBEA)

## Assessment

Students will: (1) identify tax laws as having a social or economic purpose, and (2) state the social or economic purpose of tax laws.

## Business Skill

Financial Planning: Taxation is a financial planning area where conflicting economic and social goals must be balanced. CPAs provide the technical expertise that helps individuals and businesses, as well as private enterprises, improve their financial position.

# Procedure

- **Distribute a copy of the Overview to your students and discuss the two purposes of taxation — social and economic.**
- **Explain** that contrary to popular belief, the Internal Revenue Service does not create tax laws. Congress, as the law-making body of our democracy, enacts and passes tax laws and is therefore responsible for the structure of our tax system. The Internal Revenue Service is the agency that enforces the tax laws, similar to the way the courts enforce other laws passed by Congress.
- **Discuss the programs and services the government provides with our tax dollars.** For example, student loans for college, senior citizen housing, health assistance, unemployment compensation, national defense, summer youth programs and city and state infrastructures such as roads and parks.
- **Provide each student with a copy of Activity #11.**

### PART 1

**Divide your class into teams.**

Explain that tax laws are enacted to either raise revenue — an economic goal — or to improve an individual's or society's financial position — a social goal — or in some cases, to do both.

**Complete Part 1** of the activity.

### PART 2

**Assign a "tax fact" to two students, or to two teams of students, and assign, or have students adopt, a position to debate that supports or challenges their "tax fact."**

## TEACHING-TIPS

For a complete lesson and activity on tax-deferred savings plans (401(k)), see Activity #9, *Tax Laws Can Make You Rich*.

Did you know that \$250 of educator expenses can be deducted from income?

Videotape the debates to illustrate students' strengths and weaknesses in public speaking.

# Overview

The concept and implementation of a tax system can be traced back to the founding of America in 1776. It was not until 1913, however, that the United States introduced an income tax with the 16th Amendment to the Constitution. Contrary to popular opinion, the purpose of the United States income tax is not solely founded as a means to raise revenue. In addition to setting economic policy, income taxes are also used to set social policy. That is, income taxes serve to accomplish two goals—economic and social.

The **economic goals of an income tax** include raising revenue to operate the government, expanding investment, reducing unemployment and controlling inflation. The purpose of an economic goal is to maintain, and when necessary, improve the overall health of the national economy. **Income tax laws with social goals**, however, are aimed at improving individual financial welfare and in turn, the overall well-being of society as a whole. Examples of tax laws with social goals include child-care credits, charitable contribution deductions, the Education and Roth IRAs (Individual Retirement Account), and employer-sponsored, tax-deferred savings plans (i.e., 401(k) and 403(b) plans).

As a democratic government, elected representatives debate tax laws in Congress. As a result, arguments concerning who pays and who benefits from taxation are usually answered by a compromise whereby the average citizen pays taxes *and* receives benefits from the government's spending of tax dollars.

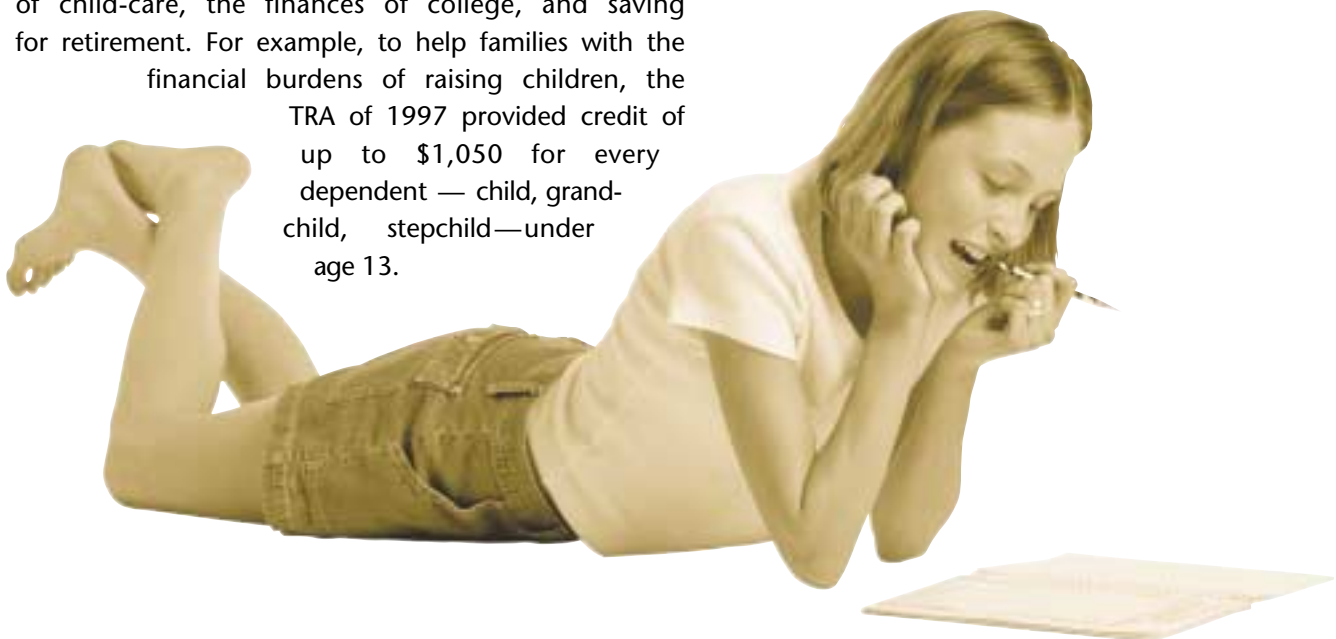
In 1997, Congress passed a Tax Relief Act (TRA of 1997) aimed at improving the financial position of the average person and assisting individuals with the expenses of child-care, the finances of college, and saving for retirement. For example, to help families with the financial burdens of raising children, the TRA of 1997 provided credit of up to \$1,050 for every dependent — child, grandchild, stepchild—under age 13.

To provide various forms of college tuition relief, the TRA of 1997 makes available the Hope Scholarship Credit, worth up to \$1,500 a year, and the Lifetime Learning Credit, which is worth up to \$2,000.

In addition, those individuals paying for their college education or their dependent's can deduct up to \$3,000 from their income. Congress has also made available the Education IRA that allows any individual to contribute \$500 per year to an IRA as a means to fund the rising costs of college tuition. The advantage of the Education IRA, as opposed to other savings vehicles, is that the contributions to the IRA and the earnings it generates may be withdrawn **tax-free** if they are used to pay for college tuition.

To assist with funding for retirement, Congress provided the Roth IRA, named after Delaware Senator William Roth. Under the TRA of 1997, taxpayers can contribute up to \$3,000 a year for themselves and \$3,000 a year for their spouse to a "Roth IRA" and **never pay taxes** on the contributions and earnings upon withdrawal. A Roth IRA, to which contributions are made, can consist of stocks, bonds, mutual funds, money market accounts, and certificates of deposit, as well as other investments, or a combination of the aforementioned.

The purpose of taxes continues to be an important topic of discussion. In 2001, Congress passed a heavily debated law that cut taxes by \$1.35 **trillion**. In addition to increasing the child-care and education credit amounts and the amount that can be contributed to tax-deferred savings plans and IRAs, the law also reduced individual income tax rates and provided rebate checks of up to \$600 for taxpayers.



# Activities

## PART-1:

**FIRST**, identify each of the following “tax facts” as having a social goal, an economic goal, or both. For each correct answer, you will receive **10 points**.

**THEN, IF** you correctly identify the goal, you will have the opportunity to state the purpose of the tax law and, if correct, receive an additional **10 points**.

### For example:

**TAX FACT:** Individuals are allowed to lower their taxable income by deducting \$3,050 from income for every dependent, such as children.

**GOAL:** Social

**PURPOSE:** Grant parents and other taxpayers financial relief from the cost of supporting children and other dependents.

## Tax Facts

1. Taxes paid on cigarettes cannot be deducted in arriving at taxable income.
2. Alimony payments may be deducted in arriving at the payer’s taxable income.
3. Interest paid on a home mortgage may be deducted when calculating taxable income.
4. Income from rental property is taxable income, and expenses associated with the property can be deducted from that income.
5. Expenses incurred in moving from one residence to another can be deducted from income if certain conditions are met.
6. Interest of up to \$2,500 a year on student loans for college tuition can be deducted from income when calculating taxable income.
7. Child support payments are not taxable income to the recipient.
8. Money or gifts contributed to a charity may be deducted from income when arriving at taxable income.
9. Individuals paying for college can lower their taxable income by deducting up to \$3,000 per year from income.
10. Individuals are allowed to subtract from income the greater of allowed expenses (itemized deductions) or a “standard deduction” when calculating taxable income.
11. If you are a professional gambler, gambling winnings greater than \$600 are taxable income and gambling losses up to the amount of winnings can be deducted in arriving at taxable income.
12. Interest paid on credit cards may not be deducted from income when calculating taxable income.

## CPA-GRADING-SCALE:

Points	Grade	Rating
210 or more	A	A guru of a CPA!
180 or more, but less than 210	B	Ready for the CPA exam
150 or more, but less than 180	C	Should take more Accounting courses
120 or more, but less than 150	D	Better start studying!
less than 120	F	Go back to Accounting 101!

Tax Fact	Goal	Points	Purpose	Points	Total Points
#1					
#2					
#3					
#4					
#5					
#6					
#7					
#8					
#9					
#10					
#11					
#12					
			<b>Total Points</b>		

**PART - 2 :**

Contrary to popular belief, the Internal Revenue Service does not create tax laws. Congress, as the law-making body of our democracy, enacts and passes tax laws and is therefore responsible for the structure of our tax system. The Internal Revenue Service is the agency that enforces the tax laws, similar to the way the courts enforce other laws passed by Congress.

*Evaluate each presentation that supports or challenges a “tax fact” based on the following categories. For each category, assign a score between 0 and 10, with 10 being an excellent score and 0 being a poor score.*

*Emotional Appeal :* Did the presentation interest you?

*Use of Evidence :* Did the presentation include empirical evidence, as opposed to unsubstantiated hearsay or personal opinion?

*Overall Quality:* Did the presentation include anecdotes and personal experiences, as opposed to abstract or theoretical examples?

*Organization:* Did the presentation build a logical flow from assumptions and premises to conclusions?

**Debate Scorecard**

Evaluation Criteria	Team “FOR” Tax Fact	Team “AGAINST” Tax Fact
Emotional Appeal		
Use of Evidence		
Overall Quality		
Organization		
Total Points		

# Answers

Tax Fact	Goal	Purpose
#1	Social and Economic	S: Taxes on cigarettes serve as a deterrent to smoking. E: Taxes on cigarettes are used to finance the efforts to educate and inform the public of the health risks associated with smoking.
#2	Social	Alimony payments are intended to place divorced couples in a financially equitable position. The payor can deduct alimony payments; the recipient must claim alimony payments as income.
#3	Social	Grant financial relief to individuals wishing to purchase a home in light of escalating housing costs.
#4	Social	Encourage individuals to invest in activities that improve society as a whole, and specifically, encourage landlords to maintain and improve the living conditions of their tenants.
#5	Social	Grant individuals a form of financial relief from the cost of moving.
#6	Social	Grant individuals a form of financial relief from the escalating cost of a college education.
#7	Social	Maintain or provide financial support for the children of divorced couples. Child support payments cannot be deducted by the payor and are not taxable income to the receiving spouse.
#8	Social	Encourage individuals to support worthy charities and not-for-profit organizations that in turn assist various less fortunate segments of society.
#9	Social	Grant individuals a form of financial relief from the escalating cost of a college education.
#10	Social	Grant taxpayers financial relief by allowing at the least a minimum amount to be deducted from income in arriving at taxable income.
#11	Economic	Individuals must pay taxes on all earned income regardless of profession or form of payment (i.e., cash, gifts, services).
#12	Social	Encourage individuals to rely less on credit and in turn encourage those individuals to invest or spend with "real" income or "real" dollars.