



Tax Basics — What Every Accounting Major Should Know

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Agenda

- Introduction
- Objectives of tax policy
- Origination and sources of tax law
- Book income as the foundation for tax
- Role of tax in business decision making
- Areas of tax practice
- Career considerations

Why care about taxes?

- “Our economy is ‘tax relevant’ in almost every detail.”*
 - Tax can affect most major business and personal decision making, so it is important for professionals to understand the tax implications of various alternatives
- As such, it is imperative that future business leaders understand the impact that taxes can have on decision-making and engage skilled tax professionals to ensure that the appropriate amount of tax is paid – no more, no less

Taxes come in all shapes and sizes

- The primary purpose of imposing taxes is to raise revenue for governments
 - Provides services to constituents such as roads, security, shelter
 - All levels of governments impose various types of taxes

Governments rely more heavily on some taxes than others

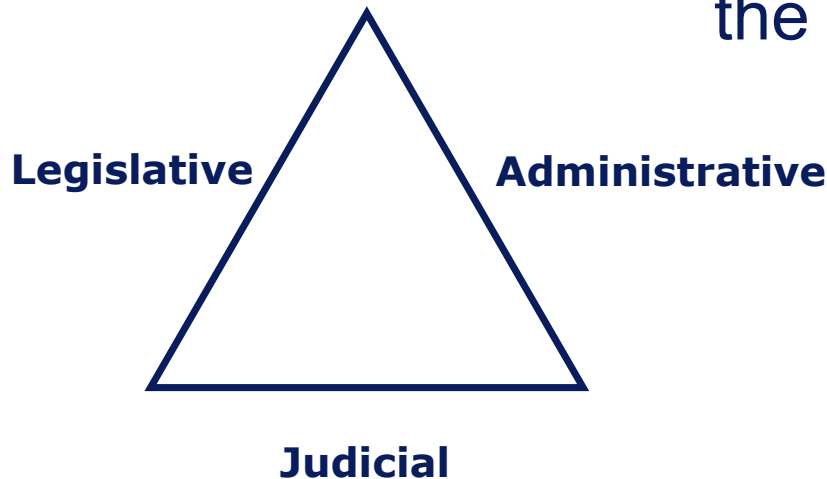
Federal	Income tax, employment tax
State	Sales tax, excise/franchise tax
Local	Property tax

Objectives of tax policy

- The U.S. takes a Keynesian approach to creating tax policy
 - While the primary goal of taxes is to raise revenues, governments also use taxes to achieve certain economic, social and even political goals

Goal	Example
Economic	Tax depreciation
Social	Education credits
Political	Elimination of double taxation

Origination of tax law



- Tax law is created by Congress and the President of the United States
 - Bills begin in the House Ways and Means Committee and then go to the floor of the House of Representatives
 - Bills continue to the Senate Finance Committee and then go to the floor of the US Senate
 - Finally, the bills reach the President for signature or veto

- The Treasury Department via the Internal Revenue Service (“IRS”) enforces the laws
- The Courts interpret the law to resolve any conflicts

Sources of tax law

- Tax laws are codified in the Internal Revenue Code (“IRC”)
- Tax laws between the U.S. and foreign governments are found in tax treaties
- States and localities also have tax laws
- IRS issues guidance on the interpretation of tax laws
 - Examples: Treasury Regulations, Revenue Rulings or Revenue Procedures
- Tax services offer editorial advice
 - Examples: CCH, RIA, Lexis Nexis

Book income as the foundation for tax

- The IRC states that the calculation of taxable income starts with income as reported in a company's books and records
- Potential choices
 - GAAP basis
 - Tax basis
 - Foreign country basis if foreign-owned
 - Other basis
- Publicly-traded corporations are required to use GAAP for book purposes – the accounting taught in financial accounting courses

Book income as the foundation for tax (cont.)

Sample Income Statement

Sales	\$1,000,000	100%
Cost of sales	<u>520,000</u>	<u>52</u>
Gross margin	480,000	48
Salaries	80,000	8
Rent	50,000	5
Other operating	<u>70,000</u>	<u>7</u>
Net income before tax	280,000	28
Income tax	<u>110,000</u>	<u>11</u>
Net income	<u>\$ 170,000</u>	<u>17%</u>

Next to cost of sales, income tax is generally the single largest expense item on the income statement

Book income as the foundation for tax (cont.)

- Book net income is then adjusted for the differences between the book rules and the tax law
- Thus, it is important for a tax practitioner to have a strong knowledge of financial accounting, as well as an understanding of the underlying tax law

Many book/tax differences

- There are many different book/tax differences:
 - Fines and penalties
 - Meals and entertainment expense
 - Unrealized gain/loss
 - Depreciation
 - Deferred revenue
 - Accrued compensation
- Book/tax differences are policy driven. In other words, Congress tries to achieve a specific goal through the mechanics of the book/tax difference.

Role of tax in business decision making

- Tax law is constantly evolving, and changes in the tax law can dramatically impact a business's economic situation
- This is where tax professionals can best utilize their skills: by being familiar with the taxpayer's industry and business and being current on tax law that affects each
- Each taxpayer is obligated to pay their fair share of taxes – but no more
- Savvy business people know when to engage tax professionals to ensure that after-tax wealth is maximized

Role of tax in business decision making (cont.)

- Taxes should be considered when making decisions related to the following:
 - When establishing a business, the type of entity that is chosen
 - Where a company chooses to base itself out of and where to operate as it expands
 - When a company chooses to time certain transactions, such as capital improvement projects
 - How a company chooses to compensate its employees
 - How a company returns the investment of its owners
- But, don't forget the non-tax issues

Areas of tax practice

- Tax practice is more than just:
 - A business where the singular goal is to achieve the biggest refund every year
 - A business that gets busy for about six weeks every winter when companies send out the W-2s and 1099s
 - A business that gets super busy the weeks leading up to April 15 each year

Areas of tax practice (cont.)

- Tax Compliance: Preparing and filing tax returns—corporate, partnerships, individuals, trusts, etc.
- Tax Consulting: Using knowledge of tax law to assist a taxpayer in properly planning /structuring a transaction
- Tax Litigation Support: Acting as a member of the litigation team to defend a client in a dispute with the tax authority
- Tax Academics: Sharing knowledge of tax law to teach students in undergraduate and graduate accounting programs, as well as in law school programs
- Tax Research: Finding answers to tax-related questions. This function is generally the support to the other areas of tax practice.

Career considerations

- Tax careers offer exciting and challenging opportunities for CPAs
 - Do you have strong GAAP accounting skills?
 - Do you like seeing clients in a variety of industries?
 - Would you enjoy helping your clients to reduce their tax burden?
 - Are you organized?
 - Are you hard-working and focused on serving clients?
 - Do you enjoy research?
- Successful tax professionals demonstrate:
 - A passion for lifelong learning
 - Attention to detail while at the same time not losing “the forest for the trees”
 - The ability to craft logical and persuasive arguments
 - Strong organizational skills

Poll question #1

TRIVIA QUESTION: According to IRS statistics, how many corporations filed income tax returns in 2005?

- 175,622
- 954,726
- 1,799,530
- 134,372,678

Poll question #2

TRIVIA QUESTION: Of the 1,799,530 corporate income tax returns filed for 2005, how many corporations actually paid tax?

- 10%
- 53%
- 67%
- 100%

Poll question #3

In which of the following business scenarios does tax play a role?

- Designing a compensation plan for key executives
- Opening an out-of-state manufacturing plant
- Increasing research and development effort
- Acquiring a competitor business
- Choosing when to make a charitable contribution
- All of the above



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