

The University of Michigan Business School
A560 -- Federal Taxation and Managerial Decisions
Fall 2007

Instructor: Jim DeSimpelare
Classroom: E0550
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Course Objective:

To provide a basic understanding of U.S. tax laws and how to apply that understanding in making financial decisions in both a business and a personal context.

Course Resources:

- 1) Spilker, et al, Taxation of Individuals (McGraw-Hill Irwin) – **required**.
- 2) A560 Course Materials – **required**.

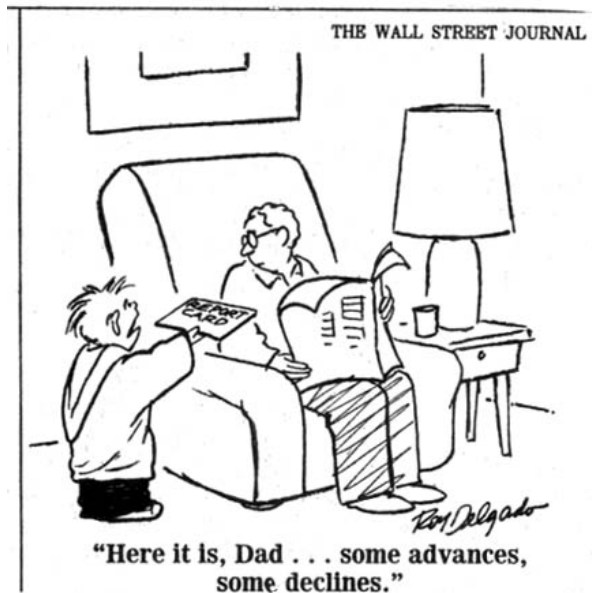
The Course Materials represent “incomplete” lecture notes for the semester. The Course Materials may be obtained in one of two ways. First, the Course Materials may be obtained as “no cost” Course Materials from the Ross Business School Kresge Library. Second, the Course Materials may be downloaded from the A560 ctools website, module-by-module (there are 10 modules in all). After the lectures for each module have been given, the completed Course Materials for that module will be posted to ctools. The solutions manual containing solutions to the suggested homework problems is also available on ctools.

Grading:



Course grades will be based on the following point allocation:

Midterm exam	175
Final exam	175
Class participation	75
Case study	<u>75</u>
Total	500



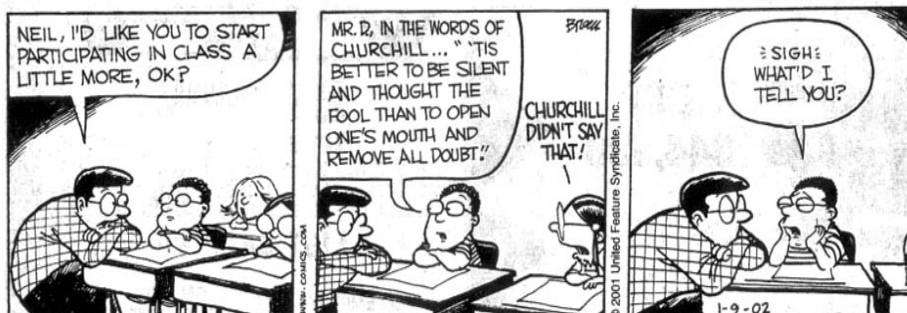
Midterm and Final Exams:

The midterm will be given on Tuesday, October 16th from 7:00-9:00 in E0540 and E0550. The final will be given on Tuesday, December 18th from 7:00-9:00 (the location will be announced later). Both exams are open-book, open-course materials.

Class Participation:

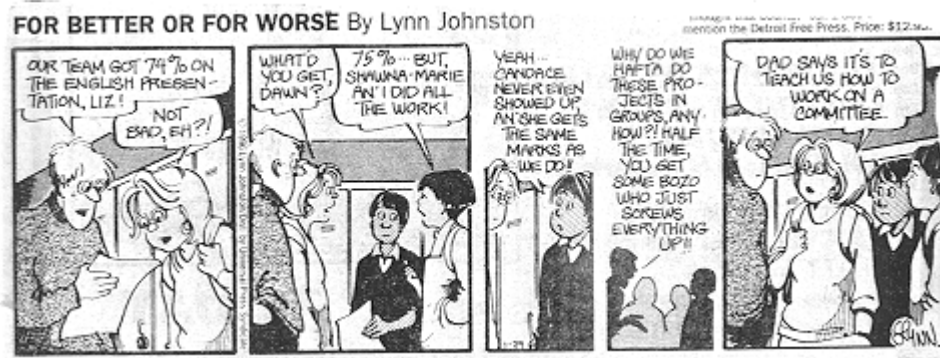
Class participation will be based on quality of input, not quantity of "air time". Quality class participation includes both insightful comments *and relevant, thoughtful questions*. Regular attendance and appropriate preparation are essential in scoring highly in class participation, and, more importantly, in getting the most out of this class. As you might expect, *showing up to class late and ringing cell phones* are detrimental to your class participation grade.

GRAND AVENUE



Case Study:

In this project, you will identify, analyze, and report on the implementation of a real world tax strategy. The case studies should be ***decision-oriented***; *strategic* as opposed to *descriptive*. This means that the case studies should report on some type of ***deliberate decision*** made by a taxpayer in order to maximize the taxpayer's financial position, as opposed to simply describing tax law, recent changes to tax law, or how courts have interpreted tax law.



The best case studies are those that:

- focus on a taxpayer's strategy involving tax issues,
- **identify and analyze the tax and nontax tradeoffs associated with that strategy**, and
- evaluate the taxpayer's adopted strategy in light of these tradeoffs.

The worst case studies simply describe how some particular tax law affects a company.

In other words, the goal is to examine **how decisions are made with respect to tax issues**.

Making the best decisions requires a comprehensive analysis of the tradeoffs of the various alternatives that are available.

So, case studies that identify and develop these tradeoffs are useful. An example of a great case study from the past dealt with a firm deciding to locate operations in Puerto Rico. (Under tax law at the time, companies received tax breaks for doing business in Puerto Rico). So, it would seem that relocating to Puerto Rico would be a great idea. However, as you might expect, there are significant nontax costs to identify and analyze before such a decision should be made. One of the primary nontax costs in this case is the lower before-tax return available on investments in Puerto Rico because of a lesser developed infrastructure and a lower quality workforce in Puerto Rico, relative to the U.S. (Actually, this lower before-tax rate of return represents an ***implicit*** tax, similar to the idea that municipal bonds offer lower before-tax rates of return). As it turns out, in many cases it ***does*** make sense for certain activities which require little skilled labor to be relocated to Puerto Rico, while other activities which require highly skilled labor operations should kept in the U.S. (e.g., many drug companies do their R&D (which requires a skilled workforce) in the U.S. and Europe, but actually package the drugs (which require minimal skills) in Puerto Rico).

Case Study, continued:

As indicated above, one case study did a great job of developing this Puerto Rico tax credit issue and the associated tax and nontax tradeoffs.

On the other hand, descriptive case studies generally are not that useful. Examples of descriptive case studies include cases that simply:

- describe a tax law (or a change in tax law), or
- describe a tax issue that is currently being litigated, or
- describe a tax break that is being used by a certain company (unless this tax break requires the company to undergo an intriguing/innovative/imaginative transaction)

The bottom line is that cases with trade-offs are good. Cases that are just descriptive are bad. However, descriptive case studies can be good if they deal with an unusual and/or complex transaction that is being done primarily for tax reasons. (In other words, I have had good cases that describe a complex tax maneuver performed by a corporation. There weren't a lot of tradeoffs to analyze, but the innovation and imagination associated with these transactions MORE than made up for the lack of tradeoffs).

Your report will be a 35 minute oral presentation. Note that the 35 minutes is *inclusive* of questions and answers. The audience is allowed – in fact, encouraged – to ask questions DURING the presentation. (This is to give you practice presenting under “real world” conditions). You should anticipate that questions and answers will take *at least* 10 minutes; thus, your prepared presentation should last NO LONGER than 25 minutes. If questions consume more than 10 minutes, you will have to reduce your formal presentation time accordingly. (This is meant to give you practice in revising a presentation “on the fly”, which, as it turns out, also reflects “real world” conditions).

The oral report should include:

- a brief overview of the case
- a discussion of the tax issues involved – here, it is VERY important that you CLEARLY explain the tax issues involved so that your classmates have a solid understanding of the strategy you are presenting
- a discussion of relevant nontax factors (e.g., financial accounting considerations)
- if possible, an estimate of the present value (in \$), of the tax planning strategy
- an opinion of whether the taxpayer made the right decision by pursuing this strategy

Please email to me, by 5:00 pm on the day prior to your presentation, the file containing your presentation slides. I will then post the file to ctools so that other students may download the slides prior to your presentation. Note that the information covered in the reports will be tested on the final exam.

Case Study, continued:

I am seeking to accomplish many objectives by assigning this case. One is to make you more aware of how pervasive tax issues are in the business world. A second goal is to develop your ability to analyze and digest complex tax issues. Last, but certainly not least, is the goal of developing your ability to clearly present technical issues in an oral presentation format. Accordingly, you are to assume that your target audience is the rest of the class (as opposed to me). A large part of your grade will depend on how effectively you communicate your case study project to your classmates.

Some examples of excellent case studies done in the past:

- Eli Lilly and Company and the Puerto Rico Tax Credit (described above)

- Unrelated Business Income and the University of Michigan

(Tax exempt entities like colleges and hospitals must still pay tax on that income that is unrelated to the mission of the exempt entity. Such income is called “unrelated business income”. This case dealt with how UM tried to minimize how much of its various sources of income (e.g., rental of Yost Ice Arena to the public, parking lot receipts during football games) was treated as unrelated business income).

- X Corporation’s Acquisition of Y Corporation

(an acquisition of a privately-held company by a publicly-held company, dealing with the tax and nontax tradeoffs of how to structure the deal, e.g., cash vs. debt vs. stock)

- Inventory Valuation and the Cost of Going Public

(a steel company wrestles with the issue of whether to adopt FIFO inventory accounting instead of LIFO with the tradeoff of the tax advantages of LIFO accounting vs. the lower reported GAAP earnings of LIFO as the company goes through an IPO).

- Estee Lauder: Selling Short Against the Box

(an analysis of how the founding family of this cosmetic giant “shorted” Lauder stock instead of selling the stock that they actually owned in an effort to defer the capital gains taxes that would have arisen on an actual sale of stock owned by the Lauder family)

- State Tax Planning Strategies

(an analysis of how a multi-state corporation rearranged its operations to take advantage of variations in how the various states in which the corporation did business determined the amount of income taxable by that state)

- Form of Organization for a Small Business Independent Insurance Agent

(an analysis of the tax and nontax issues associated with a small business doing business as a C corporation, an S corporation, or as a sole proprietorship)

Case Study, continued:

The above case studies were interesting and useful. On the other hand, I've also received case studies that were descriptive in nature and thus were NOT interesting and useful. These typically simply attempt to DESCRIBE a recent tax law or recent Tax Court decision instead of how a taxpayer PROACTIVELY engages in tax planning to maximize his/her/its after-tax wealth.

The guidelines I have given you are intentionally general to permit you some latitude in identifying a tax-planning problem of particular interest to you. Be imaginative in your search for case study ideas. Review the financial press, financial statements, investment analyst company reports; consider strategies implemented by your employer(s) or former employer(s); talk with contacts in the public accounting profession; use data bases (e.g., LEXIS/NEXIS) to search for information on tax planning strategies. (When using these data bases, *you may wish to include the name "Robert Willens" in your search – Robert is a tax expert for Lehman Brothers, a Wall Street firm, and is often quoted by the financial press with respect to "hot" tax planning strategies*). I have also posted to ctools a webpage listing electronic resources available on the Business School library website which you might find helpful in identifying a case study topic (this webpage is labeled "Library Resources for Case Study Project").

The first team to approach me about a specific case study idea will have first rights to that idea. Also, presentation dates will be awarded on a first come-first served basis, i.e., the first teams to have their case study idea approved by me will have first choice of presentation dates. Teams that do not have an approved case study idea by the midterm (October 16th) will be randomly assigned the remaining unselected presentation dates.

Start the identification process early - the most difficult part of this assignment is identifying an appropriate case study idea.

Students With Disabilities:

If you think you need an accommodation for a disability, please let me know at your earliest convenience. Some aspects of the course, the assignments, the in-class activities, and the way I teach may be modified to facilitate your participation and progress. As soon as you make me aware of your needs, we can work with the Office of Services for Students With Disabilities to help us determine appropriate accommodations. I will treat information you provide as private and confidential.

A560 Course Outline

Lecture #	Date	Module #: Topic	Reading	Suggested HW problems	
			Assignments	Disc Questions	Problems
1	9/4	1: Introduction to Tax Planning, Tax Law and Basic Tax Concepts	Ch 2 (pp 1-24) Ch 3 Ch 6 (pp 15-24) Ch 15 (pp 52-61)	8,11,21,22 1,2,8,16,17 9,10,12,25 33,35,36,40	51,52,56,69 31,32,45,50,51 45,46,51,55 42,43
2	9/11	2: Property Transactions	Ch 7 (pp 12-21) Ch 12 (pp 1-35) Ch 13 (pp 1-21, 28-53)	8,10,14,15,16 1,6,8,10,18,20,21,26,29 6,7,8,9,10,11,13,16,17, 18,19,25,27,29,30,34	44,45,47,48,50,52 39,43,46,48,54,55 37,41,42,43,45, 46,48,49,50,54,57
3	9/18	3: Taxation of Investments	Ch 7 (pp 1-11, 22-26, 29-31) Ch 9 (pp 37-43)	1,6,7,11,21 29,30,31,32,44,45,47	37,40,53,55 73,76,77,80,81
4	9/25	4: Salaries, Deferred Comp, Pensions	Ch 8 (pp 1-12) Ch 9 (pp 1-36, 44-48)	4,5,9 1,2,5,7,9,12,14,18,27, 38,39,40,42	28,31 63,65,66,71,72
5	10/2	5: Compensation Planning	Ch 6 (pp 25-34) Ch 8 (pp 12-44)	19,20,21 10,11,13,16,23,24	59,61 33,34,36,38,41,42, 43,46,48,50,51
6	10/9	6: Cap Structure & Corp Dist.	Ch 14 (pp 9-37) Ch 15 (pp 49-52)	11,17,18,19,25,30,32,38 7,24,29,30	68,74,75,76,79,81 1,34,35
	10/16	Midterm Exam (mod 1-6; 7-9 in E0540 & E0550); deadline for getting approval for case study ideas			
	10/23	No class: MBA Forums and Professional Development			
7	10/30	7: Organizational Form & Tax Shelters	Ch 10 (pp 33-36) Ch 14 (pp 1-9, 37-59)	32,33,34,35,36 5,12,13,14,16,40,41, 49,50,51	56,57 55,59,60,61,62,65 66,83,84
8	11/6	8: Mergers and Acquisitions	*Ch 13 of Jones (pp 351-367)	1,3,4,5,6,7	<u>Application prob.</u> 1,2,4,5,6,9,11,15
		* "Ch 13 of Jones" is the 2 nd to last chapter in the text, between Spilker Chapter 15 and Spilker Chapter 22.			
9	11/13	9: Estate and Gift Taxation	Ch 22	2,7,9,12,18,34	8,18,19,24,27,30
	11/20	No class: Classes that normally meet on Thursday evenings meet tonight instead!			
10	11/27	10: Personal Tax Planning	Ch 5 (excl. App.) Ch 6 (pp 1-7, 34-39) Ch 7 (pp 26-28) Ch 10 (pp 9-21)	1,5,9,11,21,25,26,31,34 1,3,4,33	43,48,51,53,59,60 43,62,63,64 48
11	12/4	Case Study Presentations			
12	12/11	Case Study Presentations			
	12/18	Final Exam (modules 7-10 plus case presentations; 7-9 – location TBA)			