American Taxation Association

Volume 4, Spring, 1978

Dale L. Davison, Editor
Arizona State University

PRESIDENT REPORTS

ATA NEARING SECTION STATUS

As reported in previous issues of the ATA Newsletter, the American Taxation Association applied in October, 1976, to become the Tax Section of the American Accounting Association. In this application President Vic Tidwell indicated the conditions we felt were necessary for us to operate effectively as the Tax Section. The ensuing discussions of our application at the AAA Executive Committee meeting in November, 1976, and March, 1977, prompted Chuck Horngren and David Solomons as President and President-elect of the AAA to appoint an ad hoc committee to examine the roles of all sections and regions. The ad hoc committee reported last fall and its recommendations seemed to be quite satisfactory to us. The report was circulated to our officers and trustees and no one had any substantive objections.

The ad hoc committee report was discussed at the AAA Executive Committee meeting in March, 1978. Prior to that meeting we submitted a request for Section status contingent upon the adoption of the ad hoc committee report. At this writing I have had only an informal report from last week's Executive Committee meeting. That informal conversation indicated that the Executive Committee did adopt the ad hoc committee report with "certain minor modifications" and then, acting upon our request, unanimously and enthusiastically welcomed ATA as the new Tax Section of the American Accounting Association. As soon as the complete details are available I will submit them to our officers and trustees and we will determine whether or not the rules for section operation as actually adopted by the AAA Executive Committee are satisfactory to us. Hopefully, our tax section status has now been achieved, but this will not be official until the ATA officers and trustees have ratified the action.

It is abundantly clear that the AAA Executive Committee wants us as the Tax Section. Further, it is clear that they want to encourage and promote special interest sections as a means of serving AAA members more effectively. It is quite understandable that they need to have rules for sectional operations which can apply to all sections. It is also understandable that they want the sectional and regional structure to strengthen the American Accounting Association and not to be divisive or detrimental to the national organization. I am confident that we can work out an arrangement that will be satisfactory to both groups and which will strengthen both ATA and AAA.

ATA Testifies in Washington

Primarily as a result of Congressman Al Ullman's appearance at our Portland meeting, the American Taxation Association was invited to testify before the Ways and Means Committee on President Carter's 1978 tax proposals. Mike Moore and his Committee to Respond to Legislative Proposals responded to this request and three members of that Committee testified on March 14, 1978. In order to utilize the time more efficiently, the Ways and Means Committee staff assigned all witnesses to a group of panels. Our representatives were assigned to a general panel which appeared on the official list of witnesses as follows:

LIST OF WITNESSES
TO APPEAR BEFORE
COMMITTEE ON WAYS AND MEANS
ON
THE PRESIDENT'S TAX PROPOSALS
TUESDAY, March 14, 1978 - 9:30 A.M. - Room 1100 Longworth House Office Building

Panel - General

Norman B. Ture, Norman B. Ture, Inc., Washington, D. C.
Ernest S. Christian, Jr., Washington, D. C.
Frederic W. Hickman, Chicago, Illinois
Sheldon S. Cohen, Washington, D. C.
Jerry Godell, President, Common Market Trading Corp., Los Angeles, Calif.
American Taxation Association:
Craig E. Reese, Dept. of Accounting, North Texas State University
Michael L. Moore, Dept. of Accounting, University of Texas at Austin
Dennis J. Gaffney, Dept. of Accounting, Michigan State University
Philip P. Storrer, Associate Professor of Taxation, California State University (Hayward)

Dennis Gaffney testified on the integration of corporate and individual taxes; Mike Moore testified on the proposal to end deferral of income of controlled foreign corporations; and Craig Reese testified on the proposal to end the deduction for gasoline taxes.

This certainly seems like a most worthwhile activity for ATA. Mike reports that the session went very well. It has generated some good publicity for our organization. For example, ATA and the three individuals were named at least twice in the BNA Daily Tax Report. Mike will report on this interesting experience at our Denver meeting.

ATA at AAA Regional Meeting

A substantial number of ATA members are involved this spring in giving papers, serving on panels, or acting as session moderators at the various regional meetings of the American Accounting Association. There are gratifying numbers of tax topics and tax professors involved in those regional programs this year. It appears that tax subjects are included in all the regional meetings except the short one-day meetings held by the Canadian Region and the Ohio Region.

It seems abundantly clear that income tax education has "come of age" and is receiving ever increasing recognition within the American Accounting Association. Obviously ATA cannot claim sole responsibility for this; however, I like to believe that we have played a significant role.

ATA in Denver

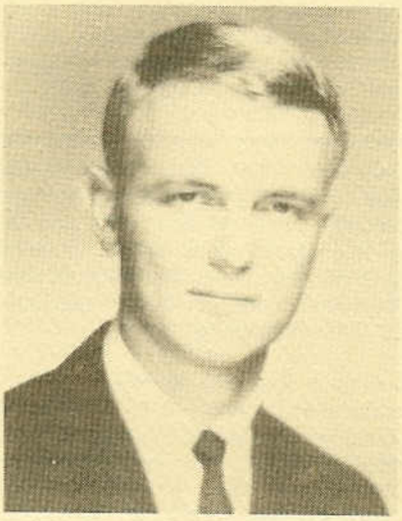
The plans for our Denver meeting are proceeding quite well. Gary Previts as AAA Program Chairman has been most cooperative and generous in allocating time for tax subjects. John Barrack as our Program Chairman is doing a fine job. We will have our business meeting with committee reports Monday morning followed by a luncheon. There will be one or more technical tax sessions on each of the three days. We will have a panel discussion on tax policy and Allen Ford's committee will present a panel discussion of their revision of the 1973 AAA publication on tax planning for the academician. There will be one session with three individuals presenting papers related to tax education and a second session with three papers related to tax practice subjects. There will be a general session on legal liability and one of the papers will be related to the tax area. The details of the program will be included in the next Newsletter.

ATA Membership

During this current year our membership has grown appreciably to a present total of approximately 600. However, I am confident that we all know individuals who should be ATA members and who are not. I propose that between now and our Denver meeting in August we

(Continued on Page 3)

Profile



Allen Ford, Jr.
Vice President

Allen Ford, Jr., Associate Professor of Accounting at the University of Kansas, has served as ATA's Vice President this year. Allen received a B.S. from Centenary College, and MBA and Ph.D. from the University of Arkansas.

He has held faculty positions at the University of Arkansas, Washington State University, and the University of Missouri, as well as visiting positions with the University of Texas and North Texas State University.

Allen has been extremely active professionally. He practiced public accountancy with Hayden & Ross, CPAs, in Idaho. He has taught in numerous professional programs and seminars, including the Peat, Marwick, Mitchell & Co. CPA Review Course, the Missouri State Auditor's CPA Review Course, the Accounting for Proficiency Seminar, the Tax Practitioners Institute, and the Kansas Tax Conference. He has served the American Accounting Association as a member of the Committee on Continuing Education and the Committee on Professional Examinations. His service to ATA includes serving as Program Chairman for the 1977 ATA Annual Meeting in Portland and current service as Chairman of the Committee to Revise the 1973 Report of the AAA Committee on Tax Information Service.

Allen has also served as review editor for **Management Advisor**, **Business Ideas and Facts**, and the **Accounting Review**. He currently serves on the review board for the **American Journal of Small Business**. His own contributions to the literature have been extensive, including numerous journal articles published in the areas of both financial accounting and taxation.

Doctoral Research In Taxation

This issue of the newsletter includes reports on two newly completed doctoral dissertations in taxation. Both Ted L. Fisher and William D. Wallace completed their doctoral studies at Oklahoma State University. Ted is on the faculty at Louisiana Tech University, and Bill Wallace is on the faculty at the University of Mississippi.

AN ANALYSIS OF THE FACTORS THAT HAVE CONTRIBUTED TO THE USE OF LEVERAGED FINANCING WITH NON-RECOURSE LOANS IN TAX SHELTERS

Ted L. Fisher, Ph.D.
Oklahoma State University, 1977

Tax leveraging with non-recourse debt is the concept of deferring or avoiding income taxes by obtaining deductions financed with funds the borrower is not personally liable to repay. The investors' exposure to loss is limited to their original investment. The use of non-recourse debt can enable some investors to derive an adequate return on their investment even though there is no cash flow from the investment and the original investment is lost.

The primary objectives of this study are (1) to identify and analyze the factors; i.e., legislative, judicial, administrative, and economic, that have contributed to the use of leveraged financing with non-recourse loans in real estate tax shelters, (2) to determine the conditions under which tax leveraging occurs, and (3) to determine the importance of tax leveraging in relation to other tax avoidance methods.

An intensive survey of the literature concerning non-recourse financing and leveraging was completed to determine what historically had been the major contributing factors to the use of leveraging with non-recourse financing in tax shelters. Next a capital budgeting model was developed for determining the effect of tax leveraging on the net present value of an investment under various assumptions. The variables manipulated included the following: land cost, depreciable balance, debt, investment, interest rate, discount rate, depreciation method, depreciation period, repayment period, cash distribution, regular tax rate, capital gains rate and the minimum tax rate. The model provides information concerning the value of leveraging as compared with accelerated depreciation, the length of time necessary to recover the original investment, the optimum termination date, and the net present value of the project. Various examples of real estate shelters were selected for analysis - to obtain evidence of the use of non-recourse loans and the conditions required to obtain such loans.

The Internal Revenue Service and Congress did very little to retard the growth of tax shelters utilizing non-recourse financing until 1969. It wasn't until the Tax Reform Act of 1976 that Congress limited the deduction for loss from properties other than real estate to an investor's "at risk" investment.

Rational investors will be more interested in the financing terms, such as the size of the down payment, loan period, and interest rate than tax avoidance provisions such as accelerated depreciation methods or long-term capital gains provisions. If an investor has a choice between several apartment investments, the investor will prefer the investment financed at a higher interest rate than a lower interest rate, where none of the projects will produce any positive cash flow to the investor and will have only a small probability of a significant terminable value.

There is a wide disparity of benefits received by investors in real estate projects marketed in the form of limited partnerships. In many instances, the general partner has reserved for himself the major benefits such as appreciation or positive cash flow by providing for a revised profit and loss ratio at a future date. Investors are able to obtain non-recourse financing on multi-million dollar projects more readily than on smaller projects.

Mortgagees seldom hold the mortgagor of real estate personally liable in case of default according to several loan officers and real estate attorneys. If this is generally true, obtaining the non-recourse provision in a mortgage is of little consequence except psychologically.

Even though Congress did not limit the deductibility of tax losses in real estate investments to the amount "at risk," the IRS could still attack some real estate tax shelters utilizing tax leveraging by arguing that the "debt" is not bonafide, i.e., indefinite as to amount and uncertain.

AN INVESTIGATION OF THE EFFECTS OF PRICE LEVEL ADJUSTED TAXABLE INCOME UPON THE ALLOCATION OF CASH TAX PAYMENTS

William D. Wallace, PhD.
Oklahoma State University, 1978

Inflation has caused many problems in the business world. One of the problems caused is a "capital erosion" of corporations due to income taxation procedures that do not take the inflation rate into consideration. One solution to the capital erosion problem that has been mentioned is price level adjustment of taxable income.

The objectives of this study are fourfold: (1) to determine if price-level adjustments will have an impact upon the cash flow required for payment of corporate income tax liabilities, (2) to determine the significance of the change in the debt ratio, capital intensity, the age of the depreciable assets, the change in the GNP Deflator, and all interactions of the variables in determining the change in tax liabilities of corporations, (3) to determine if any industry groups will be affected in such a way as to result in a reallocation of industries' shares of income tax payments, and (4) to analyze the micro-economic impact upon firms of the - changes in the tax liabilities.

A sample of 375 firms is taken from COMPUSTAT for the years 1962 through 1974, a time period that would enable analysis of the impact of price level adjustments during a period of mild rates of inflation, moderate to high rates of inflation, and during a span of years with both mild as well as moderate to high rates of inflation. After adjusting the financial statement data for the firms in the study to approximate taxable incomes, the study adjusts the tax return items in accordance with procedures prescribed by the Financial Accounting Standards Board in the exposure draft concerning price level adjustments of financial statements.

In the analysis of the impact of price level adjustments upon the cash flows required for corporate income tax liabilities, the study considers utilities separately, due to interest in utilities created by the energy crisis. Results indicate that including monetary gains and losses in the taxable income computations would produce smaller decreases in tax liabilities for nonutilities than would the exclusion of monetary items from the adjustment procedure. Excluding monetary items from the calculations of taxable income for utilities would produce decreases in tax liabilities. Including monetary items in the computations, however, would increase tax liabilities. The rate of inflation only influences the magnitude of the changes in tax liabilities: the directions of the changes remain the same.

Using regression analysis, the study determines the impact of the previously-mentioned variables and their interaction in determining the change in tax liabilities due to price level adjustments. Multicollinearity (due to the interaction variables) necessitated the use of principal component analysis to determine the variables that were mutually independent. The ensuing analysis concludes that the capital intensity of a firm, the change in the debt ratio of a firm, and the average age of the depreciable assets explain approximately 25 percent of the variation of the change in the tax liabilities due to price level adjustment of taxable incomes. Although the explanatory ability of the resulting model is not great, a validation of the model indicates the model is a good predictor of the change in tax liabilities due to price level adjustment.

Using a two-digit SIC number scheme of classification, the study groups the sample firms into industry groups. Of the industries with five or more firms in the grouping, only the measuring instrument industry would experience larger tax increases from price level adjustments including monetary items. The utility and air transportation industries would experience increases in tax liabilities as a result of price level adjustments.

To analyze the microeconomic impact upon firms of price level adjusted taxable income, the study considers only firms that are purely competitive, oligopolistic, or monopolistic. Analysis indicates the only acceptable alternative available for purely competitive and oligopolistic firms is to pass any increase or decrease in taxes along to shareholders by way of changes in dividends. Since the utility industry is the only industry that may be monopolistic, regulation by government agencies may limit the available reactions of monopolistic firms. It may be possible, however, for utility firms also to pass along tax changes to the shareholders by way of changes in dividends.

The results of the study indicate that price level adjustments may be able to combat capital erosion for most industries by reducing the cash flows required for payments of tax liabilities. The changes (decreases usually) may be channelled to replacing capital assets, thus enabling firms to generate the needed capital for operations from within. As an alternative, the firm may channel the available cash toward dividends to stockholders. The dividend increases would make the stock of the firms more desirable, thus enabling the firms to raise capital by stock issuances. The magnitude of the impact upon capital erosion would be affected by whether monetary items were included in the calculation of taxable income.

President Reports

(Continued from Page 1)

undertake a program of "each one sign up one." Use the application blank in this Newsletter to sign up one of your associates or anyone else in your area who is interested in, and wishes to support, tax education. With just a little effort on the part of each of us we should be able to have 1,000 members by the time we gather in Denver. The Membership Committee will be contacting tax professors whom they can identify and who are not ATA members, but this will be more effective if you will add a personal invitation.

AMERICAN TAXATION ASSOCIATION
MEMBERSHIP APPLICATION

Annual Dues: Member of American Accounting Association .... $10.00 ______

Annual Dues: Non-Member of AAA .... $35.00 ______

Please check your category above and send this form with your check for $10 or $35, as applicable, payable to American Taxation Association (or A.T.A.) and mail to:

G. Fred Streuling
Box 22-153 FOB
Brigham Young University
Provo, Utah 84602

Name ....

Organization ....

Address ....

.... Zip Code

Proposed by:

....
ATA Member

Telephone ( ) ....
Area Code

WORKSHOP IN TAX RESEARCH

The AAA is sponsoring a workshop in tax research just prior to the annual meeting in Denver, Colorado. This course involves the development of general concepts about tax research and the subsequent analysis of several tax articles for the purpose of relating tax research projects to these general concepts. Although some time is spent on fact-oriented case research, much of the course focuses on tax analysis research. Emphasis is placed upon the data gathering stage in the testing of tax hypothesis. Behaviorial science and quantitative analysis techniques are covered. Research in tax policy is analyzed.

Diagnostic Questions:

1. What do researchers mean by **ex post** tax research?
2. How can regression analysis be used to predict future Tax Court decisions?
3. How can a stochastic dynamic programming technique be used to maximize the future distributions from a decedent's estate to any heirs?
4. What are the two computer program packages that can be used in tax research?
5. How do you distinguish between strong and weak court decisions?

Course Instructors:

D. Larry Crumbley, James R. Hasselback, Texas A&M University

DATE: Sunday, August 20, 1978
PLACE: To be announced
TUITION FEE: $75.00
ENROLLMENT LIMIT: 30

If you are interested in attending the course, please forward your fee, name and address to: Paul Gerhardt, AAA, 653 S. Orange Avenue, Sarasota, Fl. 33577.

COMMITTEE SERVICE

Would you like to become more involved in the ongoing activities of ATA? If you have an interest in serving ATA on one of its many working committees, please contact:

Al R. Mitchell, Dean
School of Business
West Texas State University
Canyon, Texas

Much of the important work of ATA is accomplished in its small, working committees. Get involved!

ATA NATIONAL MEETING

in conjunction with
American Accounting Association
Annual Meeting

DENVER HILTON HOTEL
DENVER, COLORADO
August 20-23, 1978

Hotel Reservations can be obtained by writing:

AAA Convention Housing Bureau
225 W. Colfax Ave.
Denver, Colorado 80202

See the next issue of the Newsletter for a program of events and registration materials.

Plan to Attend!

AMERICAN TAXATION ASSOCIATION
C/O Dale L. Davison
Department of Accounting
Arizona State University
Tempe, AZ 85281

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U.S. Postage
PAID
Permit No. 12
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