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Letter from the Editor

I and our editorial board are excited to present to you the Winter 2023 issue of The Contemporary Tax Journal, a publication of San Jose State University’s MS in Taxation (MST) Program. Over the past few months, we worked with SJSU MST students, professors and practitioners to present this edition. The topics covered in this issue are current and thought-provoking.

Our 12th volume begins with our Tax Maven interview with Mr. Wayne Monfries, Senior Vice President, Head of Global Tax at Visa. He started in public accounting field and quickly moved to become one of the most well-known figures in the corporate tax field. Mr. Monfries prides himself as being a translator of the tax law. He held many elite positions throughout his career. Among other high-level positions, he was the International President of Tax Executive Institute (TEI) and the OHSU board chair. Mr. Monfries is one of the most courteous, humble, and respectful people I ever had the pleasure to meet. I had the honor of conducting this interview with him and I hope his insights and experience will inspire you.

Following this enlightening interview, delve into The Tax Enlightenment Section. This section includes an article written by SJSU MST student, Aizhan Toibazarova, where she discusses the details and conclusions of a court case - Jeffrey A. Harper, et ux., T.C. Memo 2023-57. I invite you to read this article on the application of Section 41 research credits on a construction company and the criteria for the “business component” test.

Our ensuing feature, A Focus on Tax Policy, presents a comprehensive analysis of four tax proposals by SJSU MST students, created in the MST Program’s Tax Policy Capstone course. Dive into the evaluations: H.R. 1477 (118th Congress) - Freedom to Invest in Tomorrow’s Workforce Act by Eric Varaghese and Sereyrod (Rod) Chea; H.R. 3000 (118th Congress) – Expansion of Certain Tax Preferences for Higher Education by Min Thein and Ling Yang, California AB 1249, Sales Tax Holiday for School Supplies by Michelle Buchner and Aizhan Toibazarova; and California SB 584, Short Term Rental by Khanh Le and Cheryl Gamat. These analyses conducted using the Guiding Principles of Good Tax Policy outlined in AICPA Tax Policy Concept Statement No.1\(^1\) provide valuable perspectives on contemporary tax matters.

The issue further includes insightful summaries by MST students on presentations from the 39th Annual TEI-SJSU High-Tech Tax Institute held on November 6th and 7th 2023 in Palo Alto, CA. Topics covered present summaries written by MST students on presentations made at the conference. The topics covered include current developments in the emerging disruptive

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technology such as Artificial Intelligence (AI), and beneficial ownership reporting under the Corporate Transparency Act.

I extend heartfelt gratitude to all the contributors of this issue including my fellow MST students. Also, I would like to thank Professor Annette Nellen for her continuous support, her invaluable contributions to this journal, and for being a leader in the tax profession. I am also grateful to our MST coordinator and journal webmaster Catherine Dougherty. Their insights and hard work made this issue of the journal possible.

I invite you to enjoy reading our journal and hope you will consider contributing to our upcoming issues. I now present to you the Winter 2023 issue of *The Contemporary Tax Journal*.

Regards,

Enas Al-Mais

Student Editor
For this issue of *The Contemporary Tax Journal*'s tax maven feature, I had the pleasure of interviewing Wayne Monfries. Mr. Monfries is the Senior Vice President, Head of Global Tax at Visa. He also serves as Chair of the Board of Directors at Oregon Health and Science University (OHSU). Mr. Monfries recently completed his term as International President of the Tax Executive Institute (TEI). As a well-recognized leader in the international tax field, he speaks regularly on many conference panels.

Prior to Visa, Mr. Monfries served as VP of Global Tax at TransUnion in Chicago, and prior to that served as VP & Chief Tax Officer for Nike in Portland, Oregon. An accounting graduate from Georgetown University, he began his career presenting tax interests of professional athletes and celebrities. He swiftly grew to become one of the icons in the corporate tax field.

I had the honor to interview Mr. Monfries on August 23, 2023. This interview was conducted virtually via Teams from his San Francisco office at Visa. Following are the questions I asked Mr. Monfries.

EA: How did you get involved in the tax field? Was that your plan when you were in college?

Monfries: I wanted to be a tax person since high school. I preferred tax for different reasons. As an athlete – who played football, basketball, and baseball – I would read stories about players and entertainers who got in trouble because they had crooked managers. They ended up owing the IRS money, and it would destroy them. I looked at myself and said: “well, I’m honest and I’m really good at math” so I thought to myself that looks like a field that I can get into.

I started taking some accounting courses in high school. I chose Georgetown University because 100% of their accounting graduates had a job or got admitted to a graduate school program. I graduated and got a job at a (at the time) Big 8 accounting firm. Soon after, my employer hired a partner with a portfolio of athletes and entertainers and assigned me to that partner. So, five years into my career, I was doing exactly what I thought I wanted to do – helping world-class athletes be tax compliant!

EA: What stands out as one or two of your most significant accomplishments in your career?
Monfries: I saw that question coming! Recently at Visa, our CEO retired, and I remember his retirement celebration was not about the earnings per share, revenue growth, or increase to the stock price. It was all about his leadership, his impact on people, how people respected him, and how he led and taught. I also remember when I left Nike and after I gathered the team around and informed them I was leaving, one of my team members came into my office and said: “you know, Wayne, I know this is work and its business, but you always made it personal. Thank you for that.” When I think back to that, I know that is the kind of legacy I want to leave behind.

The legacy you want to leave is that people liked working with you, and that you came across as genuine, respectful, and caring. So now that I’m here and I have people who have worked for me in the past who reach out to say I would love to join your team is a huge honor.

The other significant accomplishment is being elected International President of Tax Executives Institute (TEI). To be recognized by your peers as a leader, someone who represents them, is an amazing honor. So those are the two things; the legacy you leave with people and the honor of my peers to serve as a leader in the profession.

EA: How do you keep up to date with changes in tax law and new types of business transactions and ways of doing business?

Monfries: I’ve been fortunate to work for major companies where firms are always sending information and tax updates. But having roundtables with other colleagues about what's going on in the tax world and what's new in the industry is the most beneficial for me.

I get the most value in an in-house tax lunch or industry roundtables. The Silicon Valley Tax Directors Group, the TEI Chief Tax Officers group, the TEI International Tax Committee, and other leadership roundtables are helpful for keeping current. Getting information and insights from each other, and networking and having those conversations I think is great and the best and most entertaining way to keep up to date. We all get news from the CPA and law firms, but I think networking with our colleagues is the best, most rewarding way for me.

EA: What type of business activity are you involved with today that did not exist when you graduated from school and how did you get involved in the area?

Monfries: ESG (environmental, social, and governance practice). The transparency that we need for country-by-country reporting and showing our tax footprint (total tax contribution) around the world did not exist when I graduated. There is a new focus on being a good corporate citizen and showing how we (corporations) contribute to the economy.
EA: What do you think is one key area of our federal tax system that could/should be improved and why?

Monfries: The politicization of the tax system: we have too much public policy written into tax law and that should be minimized. Also, there is a certain disconnect between the legislators who pass the law and the authorities enforcing it – an example being the requirement to capitalize R&D (change to IRC section 174 by the Tax Cuts and Jobs Act of 2017).

EA: What advice do you have for students preparing for a career in tax?

Monfries: Tax is complicated; so, all of us who get in it are intelligent. We learned the code and the sections, and we learned how to manage them and apply them. What we don't learn is how to communicate it to those who are not us.

The key to success is the ability to communicate a complex subject in layman's terms to those who don't work in the space. I've done an interview before where I said that a big part of my job is to be a translator of tax law to those that don't tax speak.

EA: If you could have dinner with anyone (living or not), who would it be?

Monfries: That's an easy question, it's Muhammad Ali. He's a man who stood firmly on his beliefs and his faith. The impact he had on the world continues to live out in his legacy. So, I would have dinner with him to get a sense of that strength and character that comes from within.

As much as he was a spokesman and had a lot of braggadocio in his boxing career persona, he actually embraced humility and always had good intentions. The way he lived that out is remarkable.

EA: What is the most unusual item in your office or something in it that has special meaning to you?

Monfries: Anyone who's been video conferencing with me throughout the pandemic knows that I have a collection of autographed memorabilia in my home office. My favorite basketball player growing up was Julius Erving. So, I have Doctor J assigned jersey that's behind me usually. I'm a New York fan and I have the New York Yankees best players of my generation, Mariano Rivera and Derek Jeter. I have an autographed basketball with Magic Johnson, Jerry West and Kobe Bryant. My autograph collection in my office is probably the most fun thing and the stories that I tell about how I obtained those items are also fun.
Enas Al-Mais and Wayne Monfries, August 23, 2023
Can a Construction Company Claim the Section 41 Research Credit?

By: Aizhan Toibazarova, MST Student

Jeffrey A. Harper, et ux., T.C. Memo 2023-57, disagreed with the IRS’ interpretation and application of the tax law regarding the “business component” test of IRC Section 41(d). Jeffrey Harper and Katherine Harper (the Harpers), shareholders of Harper Construction Co. (HCC), an S corporation, claimed Section 41 research credits of $46,656 for 2012 and $778,610 and 2013. The IRS contended that HCC’s construction designs did not meet the criteria for the “business component” test, thereby disqualifying the S corporation, and thus the shareholders, from the research credits.

Background of the case

HCC, a construction corporation headquartered in San Diego, specialized in military design-build projects over the past decade. During the tax years 2012 and 2013, HCC reported 53 separate projects as eligible for Section 41 research credit. The array of projects, including military housing and training facilities, presented unique challenges that necessitated the integration of different aspects of the construction process.

HCC’s operational process traverses five distinct phases: job bid, conceptual design, design development, documentation, and construction. The journey commences with a bid presentation to potential clients, followed by the conceptual design phase, where layout proposals and material alternatives are explored. As the design evolves, detailed floor plans are completed, delineating building materials, systems, and implementation methods. Progressing through permitting and construction plans, HCC’s projects come to life upon obtaining client and regulatory approvals.

A notable aspect in this case was the involvement and timing of a research credit study performed for HCC by a consulting firm. The study started in 2012 but was not completed until after the tax returns were filed. The study produced compelling findings reporting “Gross Federal R&D Tax Credits” totaling $462,168 for 2012 and $387,482 for 2013. Additionally, the study elucidated HCC’s endeavors, highlighting its efforts to conceptualize innovative solutions encompassing architectural, civil, structural, mechanical, electrical, and plumbing engineering domains, among others.

Section 41 research credit

Enacted in 1981, Section 41, Credit for increasing research activities, aims to further encourage businesses to invest in technological research. The provision offers a tax credit that is equal to 20% of qualified research expenses exceeding a “base amount,” 20% of the basic research payments and 20% of the amounts paid or incurred during the taxable year by the taxpayer’s business to an energy research consortium for energy research. Alternatively, taxpayers may elect to calculate the research credit using a simplified method by taking 14% of qualified

https://scholarworks.sjsu.edu/sjumstjournal/vol12/iss2/1
research expenses that exceed 50% of the average qualified research expenses for the preceding three taxable years.

HCC employed the regular method to compute the research credit, necessitating that their qualified research expenses be linked to qualified research activities that must satisfy four threshold tests:

1. The expenditures meet the defining of research or experimental expenditures under Section 174,
2. The purpose is to discover information that is technological in nature,
3. Application of the discovered information is intended to be useful to the development of a new or improved business component of the taxpayer,
4. Substantially all of the activities constitute a process of experimentation.

Research will not qualify if it falls under the eight excluded categories of Section 41(d)(4), such as post-commercial production research or adaptation of existing components.

Per the IRS motion, the court’s focus was on the business component test defined in Section 41(d)(2)(B), which pertains to “any product, process, computer software, technique, formula, or invention which is to be –

(i) Held for sale, lease, or license, or
(ii) Used by the taxpayer in a trade or business of the taxpayer.”

To satisfy this test, the qualifying research must contribute to the development of new or improved products or processes. The IRS argued that HCC did not meet the business component test based on the following reasons:

1. Only structures built by HCC satisfy the definition of “a new or improved product,” but HCC did not own these structures.
2. HCC’s designs are not “products” but rather tangible representation of construction services.
3. Completed construction projects and designs were not “held for sale” by HCC.
4. HCC’s designs did not meaningfully impact its day-to-day operations as required by the statute.

**Court’s analysis**

The examination of the IRS’s arguments noted in their motion for partial summary judgment required a favorable interpretation of factual materials and inferences for the Harpers. Key findings of the court follow.

1. The IRS’s assertion that HCC’s designs were not “new or improved” was countered by the evidence. HCC’s comprehensive process of conceptual design and design
development led to novel ideas and continuous improvements resulting in functional improvements. The Court stated that minimum functional improvement fulfills the business component criterion according to the statute and the precedent cases.  

2. While acknowledging that HCC’s designs were not “products,” the court affirmed that they could still qualify as processes, inventions, or techniques under the statute’s definition of business components. The word “product” typically refers to tangible items meant for sale, but this does not exclude HCC’s designs from meeting the business component requirement.

3. The IRS’s claim about HCC’s ownership of constructed facilities lacked evidence in the form of contracts. Though the status of ownership remains undetermined, it is irrelevant to the task before the court which is the consideration of processes, techniques, and potential inventions developed by HCC.

4. The IRS’s argument that HCC’s designs did not meaningfully affect its day-to-day operations was based on the idea that “use” implies consistent utilization. However, the statute does not support this interpretation and there was no evidence suggesting that the business component test defines “use” as habitual application.

Conclusion

Given the existing record, it appeared to the court that HCC’s research endeavors may have led to new or improved processes, techniques, and potentially inventions utilized within its construction business. The IRS provided no solid evidence that would have proved otherwise to support their findings on HCC’s ineligibility for research credit. Therefore, the IRS’s motion for partial summary judgment was denied, as no basis existed for a legal ruling that HCC projects failed the business component test. Thus, the case will proceed for further analysis to see if any of HCC’s activities qualify for the research tax credit.
Tax Policy Analysis

H.R. 1477 (118th Congress) - Freedom to Invest in Tomorrow’s Workforce Act

By: Eric Varaghese and Sereyrod (Rod) Chea, MST Students

Introduction

Introduced in the House of Representatives on March 8, 2023, the Freedom To Invest in Tomorrow's Workforce Act aims to expand the allowable use of funds in qualified tuition programs, commonly known as 529 accounts, to cover expenses associated with obtaining or maintaining recognized postsecondary credentials. This bill seeks to amend the Internal Revenue Code of 1986 to redefine qualified higher education expenses for the purpose of 529 accounts.

Sponsored by Representatives Wittman and Spanberger, this bill has been referred to the Committee on Ways and Means for further consideration. Its official title emphasizes the freedom to invest in the future workforce by supporting individuals pursuing recognized postsecondary credentials. Section 2 of the bill introduces the provision to treat certain career training and credentialing expenses as qualified higher education expenses eligible for 529 account funds. It specifies that qualified higher education expenses now include tuition, fees, books, supplies, and equipment required for enrollment or attendance in a recognized postsecondary credential program. Additionally, fees required to obtain or maintain a recognized postsecondary credential and fees for testing and other credential-related requirements would also be covered.

The bill defines a "recognized postsecondary credential program" as a program that leads to a recognized postsecondary credential listed under the Workforce Innovation and Opportunity Act or meets the educational prerequisites necessary to take an examination administered by a reputable organization that grants credentials in a particular occupation. It appears that an example of such a credential would be a CPA license.

The Freedom To Invest in Tomorrow's Workforce Act aims to provide individuals pursuing recognized postsecondary credentials with greater financial flexibility and support. By expanding the allowable expenses within 529 accounts, this bill recognizes the value of career training and credentialing programs in preparing individuals for the workforce.¹

The table below provides an analysis of the proposed Freedom to Invest in Tomorrow’s Workforce Act using the AICPA 12 guiding principles of good tax policy.\(^2\)

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<th>Criteria</th>
<th>Does the proposal satisfy the criteria? (explain)</th>
<th>+/-</th>
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<tr>
<td><strong>Equity and Fairness</strong> – Are similarly situated taxpayers taxed similarly? Also consider any different effects based on an individual’s income level and where they live.</td>
<td>H.R. 1477 aims to expand access to recognized postsecondary credentials by allowing certain expenses to be treated as qualified higher education expenses for 529 accounts. While it promotes equity by affording more individuals the opportunity to invest in their professional growth, it is crucial to recognize that certain individuals from lower-income households might lack the funds to establish a 529 account. These individuals could also encounter barriers when attempting to access high-quality training and credentialing programs, despite the broadening of 529 account funds. A key aim of this bill is to encourage individuals to set up 529 accounts with reduced apprehension about potential non-qualified usage that could lead to the forfeiture of tax benefits. Nevertheless, disparities in the availability and quality of recognized postsecondary credential programs might persist across different income groups.</td>
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<td><strong>Certainty</strong> – Does the rule clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined?</td>
<td>The proposal primarily addresses the qualified higher education expenses that would be eligible for 529 account funds, such as tuition, fees, books, supplies, equipment, and fees related to obtaining or maintaining recognized postsecondary credentials. Notably, the proposal does not outline specific tax implications or the procedure for tax collection linked to these qualified expenses within 529 accounts. However, the existing rules and information surrounding 529 accounts clearly delineate the timing, method, and amount of taxes to be paid. The proposal might not be entirely clear to the public, especially concerning aspects like the Workforce Innovation and Opportunity Act and the nature of recognized credentials. Therefore, it becomes essential for Congress to require the IRS to issue comprehensive guidance that specifies the exact categories of credentials and educational endeavors encompassed by this bill. This action would play</td>
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a pivotal role in enhancing clarity and fostering better understanding among stakeholders.

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<th><strong>Convenience of payment</strong> – is the tax due at a time that is convenient for the payor?</th>
<th>The proposal does not directly address the convenience of payment aspect, as it focuses on the eligibility of expenses rather than the timing and manner of tax payment. However, the bill addresses the mentioned factors and provides a user-friendly tax payment structure that aligns with educational expenses. Taxpayers will have less concern of taxes later as there would be more uses for funds in a 529 plan.</th>
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<td><strong>Effective Tax Administration</strong> – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also consider the time needed to implement this tax or change.</td>
<td>The proposal may lead to increased complexity in tax administration due to the introduction of new eligibility criteria and coordination between educational institutions, credentialing programs, and the IRS. The drafters should consider proper implementation and efficient tax administration processes to minimize costs and administrative burdens.</td>
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<td><strong>Information Security</strong> – Will taxpayer information be protected from both unintended and improper disclosure?</td>
<td>The proposal does not explicitly address information security. However, to ensure compliance with data protection regulations, robust measures should be in place to safeguard taxpayer information from unintended and improper disclosure. Section 529 plans are generally managed by financial institutions, and they must adhere to various federal and state regulations to safeguard the personal and financial data of account holders. Further, the IRS has requirements in place to ensure the security of taxpayer information regarding 529 accounts.</td>
<td>N/A</td>
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<td><strong>Simplicity</strong> - can taxpayers understand the rules and comply with them correctly and in a cost-efficient manner?</td>
<td>The proposal introduces specific criteria for recognizing postsecondary credentials as qualified expenses for 529 accounts. While the proposal adds complexity on how to use 529 funds and understand what is covered, 529 accounts are designed with simplicity in mind to help taxpayers understand the rules and comply with them correctly. Also, clear guidance and educational resources can help taxpayers understand and comply with the rules.</td>
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<td><strong>Neutrality</strong> - The effect of the tax law on a</td>
<td>By expanding the use of 529 accounts for recognized postsecondary credentials, this proposal may influence</td>
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<td>Taxpayers’ decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</td>
<td>taxpayers’ decisions regarding education and training. Section 529 accounts are specifically designed to encourage saving for education expenses. The tax law does not encourage or discourage certain types of educational decisions, such as pursuing recognized postsecondary credentials over other educational options. By broadening the scope of 529 accounts to encompass recognized postsecondary credentials, the treatment of various educational expenses becomes uniform, extending its coverage to potentially include non-college learning endeavors as well.</td>
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<td>Economic growth and efficiency – will the tax unduly impede or reduce the productive capacity of the economy?</td>
<td>By expanding the allowable use of funds in 529 accounts to cover expenses related to obtaining or maintaining recognized postsecondary credentials, the proposed tax changes aim to encourage individuals to invest in education and workforce development. This could potentially enhance the overall skill level of the labor force and wages, contributing to improved economic productivity and growth.</td>
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<td>Transparency and Visibility – Will taxpayers know that the tax exists and how and when it is imposed upon them and others?</td>
<td>To meet the principle of transparency and visibility, taxpayers should be informed about the specific modifications to 529 accounts, the intended benefits, and the eligibility criteria for utilizing the funds for recognized postsecondary credentials. The tax law related to 529 accounts and the proposal is drafted in a clear and understandable manner to avoid confusion and misinterpretation. Information regarding the changes to 529 accounts are easily accessible to taxpayers through official government websites and publications which would most likely be updated to address the changes in H.R. 1477 if enacted.</td>
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<td>Minimum tax gap – is the likelihood of intentional and unintentional non-compliance likely to be low? Is there any way people may intentionally or unintentionally avoid or evade this tax or rule?</td>
<td>The proposed changes to 529 account aim to promote education and workforce development, there could still be potential for intentional non-compliance like misuse of funds and fraudulent claims. Unintentional non-compliance may arise due to confusion or lack of awareness about the specific rules and eligibility criteria for using 529 account funds for recognized postsecondary credentials like the complexity of the eligibility criteria or even administrative errors. But measures can and are put in place to mitigate the likelihood of noncompliance.</td>
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### Accountability to taxpayers – Do taxpayers have access to information on tax laws and their development, modification and purpose; is the information visible?

The proposal introduces changes to tax laws, and taxpayers should have access to information regarding these modifications, their development, and purpose. Ensuring that information is visible and accessible enhances accountability to taxpayers, information regarding the changes to 529 accounts are easily accessible to taxpayers through official government websites and publications.

It is important that taxpayers have access to information regarding these modifications and their development. Transparency in the legislative process is key. Typically, information about legislative changes is made available through official government channels, including websites and publications. This ensures that taxpayers can easily access information about the proposed changes, which aligns with the principle of accountability, transparency, and visibility.

Also, understanding the intent behind a tax policy change helps taxpayers comprehend the broader goals of the government. In this case, the purpose seems to be promoting investment in education and workforce development by expanding the use of 529 accounts. This intent should be clearly communicated to the public to enhance accountability.

Through communication, the proposal should provide a rationale for why expanding 529 accounts to cover recognized postsecondary credential expenses is beneficial for individuals and society. This includes explanations about the importance of workforce development and the role education and credentialing play in achieving this goal. Providing such information ensures that taxpayers are informed about the reasoning behind the change.

Further, ensuring that taxpayers have access to information about tax laws, their development, modification, and purpose is crucial for accountability. The proposal should not only be transparent about the changes themselves but also about the broader goals and reasons for these changes. This transparency helps taxpayers understand the impact of the proposed policy and fosters trust in the tax system.

### Appropriate government revenues

The proposal does not directly address revenue estimation. Expanding the eligibility criteria of 529 account expenses
– will the government be able to determine how much tax revenue will likely be collected and when?

| can have both positive and negative implications for government revenue. This expansion could lead to increased contributions, a decrease in tax evasion, and even potential economic stimulation. However, there's the possibility of diminished taxable income and the potential for misuse, making it challenging to accurately project the exact amount of tax revenue that will be lost.

The government might be able to gather information regarding expenditures on CPA review courses, continuing education (CE), and similar activities, although this information might not be exhaustive. Nonetheless, estimating how many individuals will utilize 529 funds for these specific purposes remains uncertain and difficult to predict.

### Tax Analysis Summary

The Freedom to Invest in Tomorrow’s Workforce Act (H.R. 1477) presents a promising proposal to expand the usage of 529 accounts for recognized postsecondary credentials and reduce the reasons why some individuals do not want to set them up. By allowing individuals to use these funds for expenses associated with obtaining or maintaining recognized postsecondary credentials, the bill aims to provide greater flexibility and support for individuals pursuing career training and credentialing programs.

The proposed bill is a step in the right direction, as it recognizes the evolving nature of the job market and the importance of equipping individuals with the necessary skills and credentials. It acknowledges that postsecondary credentials, beyond traditional degrees, hold value in today’s workforce and should be supported by tax policy.

However, there are areas where improvements could be made to enhance the effectiveness and fairness of the bill. One consideration is to provide clearer guidelines and definitions for recognized postsecondary credentials to ensure consistency and prevent potential misuse or misinterpretation. Additionally, it would be beneficial to establish mechanisms for oversight and evaluation of the programs and institutions offering these credentials to ensure quality and relevance.

Regarding the AICPA’s 12 guiding principles of good tax policy, the proposed bill aligns with some of these principles by promoting simplicity, fairness, and economic growth. The government should carefully consider the potential unintended consequences and ensure that the bill does not create disparities or distortions within the education and training landscape.
Tax Policy Analysis

H.R. 3000 (118th Congress) – Expansion of Certain Tax Preferences for Higher Education

By: Min Thein and Ling Yang, MST Students

H.R. 3000 was introduced by Congressman Lloyd Doggett, with the purpose to help more low-income students receive an education by simplifying the tax code, removing logistical obstacles, and expanding the list of eligible expenses so that students are more likely to be able to fully utilize the American Opportunity Tax Credit (AOTC). H.R. 3000 would exclude Pell Grants from gross income. It would also expand the educational expenses eligible for the American Opportunity Tax Credit (AOTC) to also cover computer or peripheral equipment, child and dependent care expenses (as defined under section 25A as amended) and course materials. The table below provides an analysis of H.R. 3000 using the AICPA’s 12 guiding principles of good tax policy.¹

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<th>Criteria</th>
<th>Does the proposal satisfy the criteria? (explain)</th>
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<td><em>Equity and Fairness</em> – Are similarly situated taxpayers taxed similarly? Also consider any different effects based on an individual’s income level and where they live.</td>
<td>H.R. 3000 increases equity and fairness for low-income students. These students are generally eligible for Pell Grants and the AOTC. Section 117 generally excludes scholarships from income, but only if used for qualified tuition and related expenses. While a Pell Grant is intended to help low-income students, to the extent a student uses it for educational expenses beyond tuition and related expenses, it is taxable (this is true for any scholarship). When the students have to pick up part of their Pell Grant as income, they may not have the means to pay the tax. H.R. 3000 addresses this issue by eliminating the need to pick up any portion of the Grant as unearned income (and also avoids the kiddie tax on these amounts). Students who receive Pell Grants may also qualify for the AOTC up to $2,500 during their first four years of postsecondary education but many fail to claim the tax credit because of the complex ways it interacts with the Pell Grant’s income inclusion. If students allocate the Pell Grant to living expenses, the AOTC can be maximized but they will pick up the entire grant money as income. By eliminating the need for income inclusion and expanding the eligible expenses for AOTC, Pell</td>
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Grant recipients and all students paying college expenses are more likely to be able to fully use the AOTC amount.

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<th>Certainty – Does the rule clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined?</th>
<th>Pell Grants used for room and board and other non-qualifying expenses have been taxed as unearned income. H.R. 3000 would repeal the taxability of Pell Grants and expand the number of students that would be eligible for the American Opportunity Tax Credit (AOTC). As a result of this proposal, Pell Grant recipients can be certain that they no longer have to include any portion of the grant as unearned income. For AOTC purposes, H.R. 3000 would expand the definition of qualified tuition and related expenses to include computer or peripheral equipment, child and dependent care expenses, and course materials. It also provides explanations and exceptions for each type of additional qualified expenses. This adds clarity to the existing term used of “related expenses” by being more specific as to these types of expenses.</th>
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<tr>
<td>Convenience of payment – is the tax due at a time that is convenient for the payor?</td>
<td>H.R. 3000 would eliminate the inclusion of any Pell Grant income from taxable income. This is convenient for the student taxpayers by reducing their tax obligations when they likely have limited funds for paying taxes on Pell Grants as that money goes directly to the university and is required to be used only for school expenses.</td>
</tr>
<tr>
<td>Effective Tax Administration – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also consider the time needed to implement this tax or change.</td>
<td>The costs to collect would be minimal since H.R. 3000 would eliminate the need to include the Pell Grant as taxable income and the expansion of the qualified expenses would be an addition to the existing definitions within an established reporting framework. The IRS will need to make modifications to Publication 970 and Form 8863, Education Credits, but the cost would be minimal since they would not be implementing brand new legislation. Taxpayers can continue to rely on modified Publication 970 and Form 8863 to claim the AOTC.</td>
</tr>
<tr>
<td>Information Security – Will taxpayer information be protected from both unintended and improper disclosure?</td>
<td>H.R. 3000 would protect taxpayers’ information from both unintended and improper disclosures since it introduces simplification by making none of the Pell Grants taxable and expands the definition of qualified education expenses for AOTC.</td>
</tr>
<tr>
<td>Simplicity - can taxpayers understand the rules and comply</td>
<td>This proposal satisfies the simplicity criteria by repealing the taxability of Pell Grants. Under current law, a student can choose whether to allocate their Pell Grant to qualified expenses.</td>
</tr>
<tr>
<td>Neutrality - The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</td>
<td>H.R. 3000 encourages low-income students to pursue an education, particularly working parents who will face additional financial burdens from the pursuance of education due to child care costs that would be covered under the AOTC.</td>
</tr>
<tr>
<td>Economic growth and efficiency – will the tax unduly impede or reduce the productive capacity of the economy?</td>
<td>H.R. 3000 will not unduly impede or reduce the economy's productive capacity. It will encourage more low-income students to pursue an education by easing their financial burden, which will ultimately contribute to long-term economic growth by supplying more talents.</td>
</tr>
<tr>
<td>Transparency and Visibility – Will taxpayers know that the tax exists and how and when it is imposed upon them and others?</td>
<td>VITA sites and schools will assist students in learning about the new rules and benefits. VITA will assist students in correctly excluding the Pell Grant from their gross income and including eligible expenses when claiming the AOTC on their tax returns. The new rules will also be included in the IRS's new form instructions, as well as many other online tax articles.</td>
</tr>
<tr>
<td>Minimum tax gap – is the likelihood of intentional and unintentional non-compliance likely to be low? Is there any way people may intentionally or unintentionally avoid or evade this tax or rule?</td>
<td>Making the Federal Pell Grant non-taxable as long as it is used for qualified purposes reduces the likelihood of income underreporting and unintentional errors. Extending the definition of eligible expenses, on the other hand, may result in overstatement of eligible expenses. Regarding the inclusion of computer or peripheral equipment in the definition of qualified tuition and related expenses, this can encourage abuse by a student buying equipment or a software program that has nothing to do with pursuing higher education. More guidance on determining eligible expenses and compliance procedures will aid in encouraging compliance.</td>
</tr>
</tbody>
</table>
Accountability to taxpayers – Do taxpayers have access to information on tax laws and their development, modification and purpose; is the information visible?

The summary and details of H.R.3000 are available on Congress.gov. Furthermore, the bill's sponsor has a discussion on their website to explain the purpose of the bill’s introduction as well as an explanation of the changes and intended goal. Because low-income students are the intended beneficiaries of the bill, VITA and student services can assist in informing students about the changes and new rules.

Appropriate government revenues – will the government be able to determine how much tax revenue will likely be collected and when?

The tax expenditure incurred as a result of making the Federal Pell Grant non-taxable (as long as it is used for qualified purposes) could be predicted based on the amount of Pell Grants made. Despite the fact that the definition of eligible expenses has been expanded, the annual limit on AOTC improves the stability and predictability of tax expenditures associated with the credit.

Conclusion
According to the principles of good tax policy, the passage of H.R. 3000 would benefit low-income students. Making the Federal Pell Grant non-taxable improves simplicity and tax administration, reduces the gap between tax liability owed and tax collected because there is less uncertainty and confusion, as well as making federal tax expenditures associated with the exclusion of the Federal Pell Grant and AOTC more predictable. Because H.R. 3000 is intended to benefit low-income students, VITA and student services would be invaluable in assisting student taxpayers in learning about the new rules and their application, as well as assisting with compliance. In conclusion, H.R. 3000 meets the principles of good tax policy other than neutrality and minimum tax gap.

Possible Improvements
- To address the issue of the minimum tax gap, which is the possibility of overstating the AOTC due to overstated eligible expenses, guidance with examples should be added to instruct taxpayers on how to differentiate eligible expenses for AOTC without complicating compliance.

- To address the issue of neutrality, rules and explanations should be clearly added to IRS Publication 970 to clarify what computer or peripheral equipment are eligible to address the abuse of claiming non-education related computer equipment, software, and other purchases.
Introduction

California bill, AB_1249 was introduced by Assemblymember Tri Ta in February 2023. The purpose of this bill is to “relieve the financial burden for families and teachers buying school supplies” by implementing a two-day sales exemption for “qualified school supplies.” The exemption, also referred to as a sales tax holiday, would be in effect for 2024 through 2028. This bill would add Revenue & Taxation Code Section 6372 to exempt sales tax on the sale of, and the storage, use or other consumption of qualified school supplies for a two-day period beginning at 12:01 am the third Saturday of July of each year and ending 11:59pm on the following day.

Qualified school supplies are included in two categories:

1. Items with a sale price under $100 each of various listed supplies such as binders, notebooks, book bags, lunch boxes, crayons, calculators.

2. The first $1,000 of total sales price for specified electronic items purchased for noncommercial home or personal use including laptops, printers, tablets, keyboards, and batteries.

The inclusive list can be found in the proposed bill AB_1249. The bill does not specify if the electronic item limit of $1,000 is per buyer or per student or how it would be tracked when purchases are made at multiple times and/or multiple stores during the two-day sales tax holiday.


<table>
<thead>
<tr>
<th>Principle</th>
<th>Application</th>
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<tbody>
<tr>
<td>Equity and Fairness - Are similarly situated taxpayers taxed similarly? Also</td>
<td>Horizontal Equity: The principle of horizontal equity is not met due to the potential variance in situations among taxpayers within similar income brackets, resulting in uneven advantages stemming from this proposal. For example, families with a</td>
</tr>
</tbody>
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1 Assembly Bill 1249 text and analysis; https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202320240AB1249.
| consider any different effects based on an individual’s income level and where they live. | larger number of children, who require more school supplies, would enjoy a more substantial tax benefit during the Sales Tax Holiday because of their greater expense on school supplies. While this proposal does impose some restrictions on the pricing of these school supplies (with qualified electronic items limited to the first $1,000 and other eligible school supplies capped at items under $100), taxpayers in similar income brackets could still disproportionally leverage this tax savings if they purchase numerous items falling under the $100 threshold compared to other taxpayers who may not purchase as many school supplies. They could also potentially surpass the $1,000 limit for qualified electronic items by making separate purchases for electronic items at different stores and by using multiple buyers (such as family members making purchases that when aggregated exceed the $1,000 threshold for electronic items). Retailers have a challenge determining whether a taxpayer has already reached the $1,000 limit on electronics through previous purchases, given that the sales tax exemption is applied at the point of sale without a log of prior transactions.

Vertical Equity: The principle of vertical equity is not met given the proposal’s advantages lean more towards taxpayers with higher income, as opposed to those with lower incomes. This discrepancy arises because individuals with greater earnings possess a higher capacity to allocate funds for school supplies in comparison to their lower-income counterparts. Despite the sales tax functioning as a uniform tax, imposing an identical tax rate irrespective of income level, the impact is disproportionate. Specifically, individuals with lower incomes allocate a larger percentage of their earnings for school supplies when compared to those with higher incomes, assuming a relatively consistent expenditure. However, individuals with higher incomes are more inclined to acquire pricier items and potentially a larger quantity of school supplies, resulting in heightened benefits from the savings derived through the sales tax holiday. In addition, lower income families might not be able to purchase all supplies and electronic items needed for the school year during the two-day sales tax holiday whereas a higher income family and more readily do so and enjoy a greater amount of sales tax savings. |
<table>
<thead>
<tr>
<th>Principle</th>
<th>Analysis</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certainty</td>
<td>This principle of certainty is partially fulfilled through the proposal. Certainty is fulfilled as the bill precisely outlines the eligible goods for the sales tax exemption and specifies the dollar threshold for the exemption. However, the element of certainty is compromised due to the seller’s inability to ascertain the intended purpose for which the buyer is acquiring the school supplies. As a result, the seller lacks control over whether they inadvertently breach the regulation by selling tax-exempt school supplies to buyers who intend to utilize these supplies for purposes other than noncommercial home or personal use. In addition, it is not clear how the $1,000 purchase cap on electronic items would be tracked and if it is per buyer or per student.</td>
<td>+/-</td>
</tr>
<tr>
<td>Convenience of Payment</td>
<td>The principle of convenience of payment is partially met by this bill. Convenience of payment is satisfied as the tax savings are administered to eligible items at the point of sale, before a final decision is made about making the purchase. Items ineligible for exemption and/or surpassing threshold values will be subject to taxation at the applicable tax rate. However, the bill does not include particular clauses addressing online transactions where items are purchased by customers in California from retailers situated outside of the state. This absence makes it challenging to ascertain whether the principle of convenience of payment applies.</td>
<td>+/-</td>
</tr>
<tr>
<td>Effective Tax Administration</td>
<td>The principle of effective tax administration is not met by this proposal. Although the state government would not incur additional tax collection costs, the implementation would necessitate the introduction of supplementary audit guidance for the California Department of Tax and Fee Administration (CDTFA), retailers and the general public. Furthermore, the bill neglects to compensate local agencies for any revenue losses resulting from this exemption. Nevertheless, the responsibility of implementing the proposed bill falls on the retailers. They would need to adapt their point-of-sale (POS) systems to accommodate the two-day sales tax holiday. Retailers also bear the responsibility of substantiating that the sales occurred within the specified two-day Sales Tax Holiday window in order to justify the exemption from tax collection. In the event of any errors, they would be held liable,</td>
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<tr>
<td>Category</td>
<td>Description</td>
<td>Rating</td>
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<tr>
<td>Information Security - Tax administration</td>
<td>Must protect taxpayer information from all forms of unintended and improper disclosure.</td>
<td>N/A</td>
</tr>
<tr>
<td>Simplicity - Simple tax laws are necessary so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.</td>
<td>The principle of simplicity is partially met. Although the bill specifies the eligible items and the threshold limits, the items listed as exempt might create confusion due to potential variations between the official definition of qualified school supplies and personal interpretations. To address this, it is crucial for retail establishments to take initiative in clearly marking tax-exempt items, facilitating customer understanding, and reducing confusion. However, vendors face the greater challenge in the enforcement of tax-free sales rules, stemming from the lack of guidance on verifying the end user’s noncommercial status and the frequency of exemption use for electronic items. These compliance gaps could significantly heighten vendors’ responsibilities, especially if items are inadvertently sold to commercial or business users.</td>
<td>+/-</td>
</tr>
<tr>
<td>Neutrality - Minimizing the effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction is important.</td>
<td>The principle of neutrality is compromised, as taxpayers would be incentivized to buy school supplies specifically during the sales tax holiday. This is highlighted by the significant benefit from the tax exemption applied to the first $1,000 spent on electronic devices, such as personal computers, laptops, tablets, etc. Furthermore, the bill’s lack of inclusivity prevents the fulfillment of the neutrality principle favoring only a particular category of essential student items, while neglecting others such as clothing and books.</td>
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<tr>
<td>Economic Growth and Efficiency - The tax system should not unduly impede</td>
<td>The principle of economic growth and efficiency is partly fulfilled by this bill. It is likely that the bill will boost sales and improve the efficiency of businesses selling tax-exempt items. It is a well-known fact that many shoppers buy things not as they are accountable for both sales tax collection and remittance to the CDTFA.</td>
<td>+/-</td>
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</tbody>
</table>
or reduce the productive capacity of the economy. Initially on their shopping list. The stores might make more sales on non-exempt items utilizing smart techniques of displaying and placing their merchandise. However, there could be less spending on other things after the sales tax holiday. Buyers with limited budgets aiming to save money on sales tax holidays might overspend and eventually limit or exhaust their resources for other purchases.

<table>
<thead>
<tr>
<th>Transparency and Visibility - Taxpayers should know that a tax exists and how and when it is imposed upon them and others.</th>
<th>The principle of transparency and visibility is met partially. While the bill clearly defines the amount to which the tax exemption applies, it is unclear how a taxpayer’s use of the exemption would be monitored to prevent misuse, like using it multiple times for electronic items or for non-qualified purposes such as buying school supplies for business use.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum Tax Gap - Structuring tax laws to minimize noncompliance is essential.</td>
<td>The principle of minimum tax gap is not met. The proposal grants sales tax exemption for school supplies and electronic items purchased only for personal use. As the bill lacks clarity on eligibility enforcement, businesses including self-employed individuals might exploit the tax holiday, ignoring a personal use requirement. The analysis accompanying AB 1249 notes possible misuse such as an individual without children purchasing a Waterman fountain pen for $95 during the two-day holiday and not paying sales tax.</td>
</tr>
<tr>
<td>Accountability to Taxpayers - Accessibility and visibility of information on tax laws and their development, modification, and purpose, are necessary for taxpayers.</td>
<td>The principle of accountability to taxpayers is met in part. Retailers can easily inform taxpayers about the sales tax holiday, but the ads might lack details about why this holiday is available to all and focused only on school supplies. Taxpayers are likely to understand lawmakers’ intent of assisting families purchase school supplies including due to the date of the sales tax holiday. They might not understand why greater assistance is not provided to low-income families and assistance is provided to high-income families.</td>
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</tbody>
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| Appropriate Government Revenues - Tax systems should have appropriate levels of predictability, stability and reliability to enable the government to determine the timing and amount of tax collections. | The principle of appropriate government revenues is not met. The temporary two-day exemption is projected to exceed $150,000. This figure is small relative to the $34 billion collected in sales and use tax revenue in 2021. However, this revenue estimate seems low as the California Dept. of Education estimates that there are over 5.8 million K-12 students in California. It likely will be difficult to obtain a estimate of the revenue loss as people may purchase more supplies and electronic items than without the exemption. |

**Summary of Analysis**

The intent of this bill is to relieve the financial burden for families and teachers buying school supplies. However, based on the tax policy analysis, the bill does not effectively achieve this intent.

The principles of equity and fairness are not upheld by the bill, as it could disproportionately benefit higher-income individuals with more disposable income for school supplies. Taxpayers might delay purchases until the sales tax holiday, compromising the neutrality principle. This is particularly true for expensive items like electronic devices as the savings can become substantial, also creating a higher revenue loss for the government.

The bill also places a substantial burden on retailers, who would need to prepare by identifying eligible items and making temporary adjustments to their POS systems. Additionally, the bill does not adequately prevent misuse of the exemption, potentially leading to noncompliance and higher revenue loss.

Employing an established tax collection system could offer a straightforward way to administer tax laws. However, a more effective strategy could involve directly distributing school supplies or issuing vouchers to assist low-income families. This approach would align better with the bill’s intent and prevent potential revenue loss due to noncompliance.

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3 Assembly Bill Policy Committee Analysis (April 28, 2023); https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202320240AB1249.

4 State Sales and Use Tax Collections and Number of Permits (Table 18); Open Data Portal, CDTFA; https://www.cdtfa.ca.gov/daportal/dataset.htm?url=SUTStateCollNoPermits.

5 California Dept. of Education; https://www.cde.ca.gov/ds/ad/ceffingertipfacts.asp.
Tax Policy Analysis
California SB 584, Short Term Rental
By: Khanh Le and Cheryl Gamat, MST Students

California SB 584, or the "Short Term Rental" tax bill, would impose a new tax and address issues of affordable housing and fair wages for construction workers. The main components of the bill are as follows:\footnote{California Legislative Information website (May 2023) SB-584 Labor force housing: Short-Term Rental Tax Law https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202320240SB584.}

- Laborforce Housing Financing Act of 2023: This act defines “Laborforce Housing” as housing owned and managed by specific entities solely for the benefit of residents and households who cannot afford market rent. The residents of these properties would have certain protections.

- Laborforce Housing Fund: The bill establishes a fund to be used by the Department of Housing and Community Development for the creation of Laborforce Housing and other housing projects. The fund would be financed by public entities, local housing authorities, and mission-driven nonprofit housing providers.

- Use of funds: The use of the tax revenues is restricted to construction or rehabilitation projects. All construction workers involved in these projects must be paid at least the prevailing wage rate, or all contractors and subcontractors must use a skilled and trained workforce to complete the project.

- Short-Term Rental Tax: Starting January 1, 2025, the bill imposes a 15% tax on the rental price of short-term rentals in the state. Short-term rentals refer to homes, houses, rooms in homes or houses, or other lodgings that are not hotels, inns, motels, or bed and breakfasts, rented for 30 days or less. The short-term rental facilitator or the operator (depending on who processes the payment) is responsible for collecting this tax.

- Use of tax revenue: All revenues from the short-term rental tax, after refunds and administration and collection costs, will be deposited into the Laborforce Housing Fund.

- Urgency statute: The bill declares that it is to take effect immediately due to its urgency nature.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Does the proposal satisfy the criteria? (explain)</th>
<th>+/-</th>
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</thead>
<tbody>
<tr>
<td>Equity and Fairness –</td>
<td>Equity: The bill seems to address equity. The creation of laborforce housing is aimed at providing affordable housing for those unable to meet market rates, addressing economic and social disparities.</td>
<td></td>
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<tr>
<td>Are similarly situated</td>
<td>Horizontal Equity: This refers to the equal treatment of taxpayers who have the same ability to pay. SB 584 imposes a 15% tax on all short-term rentals, regardless of location, size, or amenities. While this approach applies a consistent rate across all rentals, it may not account for variations in rental prices, which could result in differing tax burdens for renters with the same ability to pay. Therefore, SB 584 may not fully satisfy the principle of horizontal equity.</td>
<td></td>
</tr>
<tr>
<td>taxpayers taxed similarly?</td>
<td>Vertical Equity: This involves the differential treatment of taxpayers according to their ability to pay, with higher-income individuals able to pay more. SB 584's tax on short-term rentals is likely to have a progressive effect, as short-term rentals are often a luxury and more commonly used by higher-income individuals. Higher rental rates will have a larger amount of short-term rental tax imposed. By using the revenue to support affordable housing initiatives, the tax serves to redistribute income to benefit lower-income households. In this sense, SB 584 may be seen as promoting vertical equity.</td>
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<tr>
<td>Also consider any different</td>
<td>Fairness: From a fairness perspective, this bill provides additional funding for affordable housing, which could be seen as a fair response to the housing crisis. But fairness can also depend on one's viewpoint. For example, some might argue that it is fair to tax short-term rentals to fund affordable housing, while others might argue it's unfair to place this burden on short-term rental operators or users that may also include low-income renters.</td>
<td></td>
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<tr>
<td>effects based on an individual's income level and where they live.</td>
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<tr>
<td>Certainty – Does the rule</td>
<td>Defined Rate: The tax rate is clearly defined as 15% of the rental price of the short-term rental.</td>
<td></td>
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<td>clearly specify when the tax</td>
<td>Defined Base: The base of the tax, short-term rentals, is also well defined in the legislation. The bill describes short-term rentals as &quot;the occupancy of a home, house, a room in a home or house, or other lodging that is not a hotel, inn, motel, or bed and breakfast, in this state for a period of 30 days or less.</td>
<td></td>
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<tr>
<td>is to be paid, how it is to be</td>
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<tr>
<td>paid, and how the amount to</td>
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<tr>
<td>be paid is to be determined?</td>
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</table>
Definitions will be needed for these terms, particularly “bed and breakfast.”

However, the bill does not provide explicit details regarding additional charges, such as housekeeping and other services. Typically, in many jurisdictions, taxes that apply to short-term rentals are calculated based on the total amount charged to the renter, including any mandatory fees and charges associated with the rental. This often includes housekeeping fees, service fees, and resort fees, among others. If such charges are considered part of the cost of the rental and are mandatory for all renters, they are typically included in the taxable amount. However, the treatment of additional charges can vary based on local tax regulations and the specific details of the rental transaction. In some cases, optional or separately itemized charges may be excluded from the taxable amount. Additionally, some jurisdictions may have specific rules for how to handle bundled charges or charges for services that are not directly related to the rental itself.

Collection: The bill clearly states who is responsible for collecting the tax (the short-term rental facilitator or the operator, depending on who processes the payment), which provides certainty about who is responsible for the tax's administration.

Usage of the Tax Revenue: The bill clearly outlines that the tax revenue will go to the Laborforce Housing Fund, which creates certainty about the use of the funds.

The proposal satisfies the principle of certainty. However, it is important to consider how additional charges are typically treated in tax policy and to consult any implementing regulations or guidance that may be issued by the California Department of Tax and Fee Administration (CDTFA) for further clarification.

| Convenience of payment – is the tax due at a time that is convenient for the payor? | California SB 584, the short-term rental tax seems to satisfy this principle based on the following points: Collection by Facilitators or Operators: The bill clearly states that the tax is to be collected by the short-term rental facilitator (if they process the payment) or the operator. This means that, for renters, the tax is likely to be included as part of their payment for the rental itself, much like sales tax is |
included in the price of goods at a store. This would make it convenient for renters, as they would not need to calculate and send in the tax separately. It appears that a facilitator might be an entity like Airbnb that would collect for owners who use their platform to find rental customers. This should make collection easier for many short-term rentals.

Defined Rate: The tax rate is clearly defined as 15% of the rental price, which makes it relatively straightforward for facilitators, operators, and renters to understand the amount owed.

| **Effective Tax Administration** – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also consider the time needed to implement this tax or change. | Variety of Rental Situations: The varied nature of short-term rentals could pose challenges for tax administration. For example, it may be difficult to track and collect taxes from individual homeowners who occasionally rent out their homes without use of a platform or website (such as AirBNB) that could facilitate tax collection or who operate informally. Enforcement: Depending on the size of the short-term rental market in California, enforcing this new tax could potentially require substantial resources, especially if individual homeowners who rent properties are not using a facilitator who would automatically collect the tax. Burden on Facilitators/Operators: Placing the burden of tax collection on facilitators or operators could result in administrative difficulties or resistance, especially for smaller operators who may not have the resources to handle this additional responsibility. California SB 584, the short-term rental tax seems to not satisfy the effective tax administration principle |
| **Information Security** – Will taxpayer information be protected from both unintended and improper disclosure? | California SB 584 does not directly address information security in relation to the new tax on short-term rentals. It does not specify how taxpayer data will be handled, stored, or protected during the tax collection process. However, considering these points, while SB 584 does not directly address information security, the facilitators and operators responsible for collecting the tax, as well as the California Department of Tax and Fee Administration (CDTFA) which is responsible for administering the tax, would still be subject to existing information security regulations. |
Since it is unlikely that owners would need to report confidential data of renters, personal information about renters, such as names, addresses, or other identifying information, is generally not necessary for tax compliance. The focus of the tax is on the occupancy of the short-term rental and the revenue generated from it, not on the individuals renting the property.

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<thead>
<tr>
<th>Simplicity - can taxpayers understand the rules and comply with them correctly and in a cost-efficient manner?</th>
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<tbody>
<tr>
<td>Based on the text of California SB 584, some elements of the bill potentially create complexity.</td>
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Implementation for Facilitators and Operators: While the mechanism for tax collection is straightforward from the renter's perspective, it may introduce complexity for the facilitators and operators, particularly for those who do not currently have systems in place for collecting such a tax.

Different Rental Situations: The nature of short-term rentals can be quite diverse, from individual homeowners renting out a room occasionally to businesses that own and rent out multiple properties. This diversity could make the tax more complicated to administer and comply with.

Enforcement: Enforcing this new tax could be a complex task, especially when it comes to individual homeowners who rent properties without a facilitator who would automatically collect the tax.

The proposal does not satisfy the principle of simplicity.

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<tr>
<th>Neutrality - The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</th>
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<tbody>
<tr>
<td>Potential Distortion of Rental Decisions: The imposition of a 15% tax on short-term rentals could potentially distort the market by influencing decisions related to property rentals. For instance, property owners might choose to shift from short-term rentals to long-term rentals to avoid the tax or increase their prices to pass the tax burden onto consumers. On the consumer side, the increased cost might discourage short-term rentals and impact the tourism industry.</td>
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</table>

Impact on Different Property Owners: The tax also impacts different actors in the market differently. It might be easier for large rental platforms or operators, who already have systems in place for handling tax collection, compared to smaller operators or individual homeowners.
Competitive Balance: Because the tax applies only to short-term residential rentals and not to traditional lodging establishments like hotels or motels, it could distort the competitive balance in the lodging market. While many cities impose transient occupancy taxes on short-term rentals, the proposed state rate might be higher or lower and affect decisions of tourists and others on where to stay for short-term rental needs.

Since bed and breakfasts are excluded, owners who rent out frequently on Airbnb, for example, are likely to start offering breakfast. If there is no specific definition of bed and breakfast businesses, this could be abusive if providing an automatic coffee maker and leaving frozen pastries in the freezer to be warmed in the microwave, for example, would convert the property into a bed and breakfast.

Thus, while the proposed bill might help raise funds for affordable housing (an important goal in itself), it might not fully align with the principle of tax neutrality due to its potential to distort economic decisions in the rental and lodging markets.

| Economic growth and efficiency – will the tax unduly impede or reduce the productive capacity of the economy? | Increased Funding for Affordable Housing: By creating a new source of funding for laborforce housing projects, the bill could potentially stimulate economic activity in the construction sector and contribute to the supply of affordable housing, which is a significant issue in many parts of California. A more adequate supply of affordable housing could, in turn, benefit economic growth and efficiency by helping to ensure that workers can afford to live near where jobs are located. The proposal seems to satisfy the principle of economic growth and efficiency |
| Transparency and Visibility – Will taxpayers know that the tax exists and how and when it is imposed upon them and others? | Clearly Defined Tax and Rate: The bill clearly defines what constitutes a short-term residential rental and sets a specific tax rate (15% of the rental price), which contributes to transparency. Ideally, owners will let renters know of the tax ahead of reserving the rental space. Collection Mechanism: The tax is collected by the short-term rental facilitator or operator at the point of transaction, which makes the tax visible to the consumer at the time of payment. | + |
| Specific Use of Funds | The revenue generated from the tax is directed to a specific purpose - the Laborforce Housing Fund. This transparency about the use of tax revenues can contribute to public understanding and acceptance of the tax. The proposal seems to satisfy the principle of transparency and visibility |
| Minimum tax gap – is the likelihood of intentional and unintentional non-compliance likely to be low? Is there any way people may intentionally or unintentionally avoid or evade this tax or rule? | Collection by Facilitators or Operators: The fact that the tax is to be collected directly by facilitators or operators at the point of transaction could help to minimize the tax gap, as it does not rely on individual renters to report and remit the tax. The facilitator’s role in collecting the tax can enhance compliance, as it centralizes the collection process. However, the bill does not provide specific guidance on how tax collection will be handled for operators who do not use facilitators. Clear collection mechanisms and guidance for both facilitators and independent operators are essential to minimize the tax gap. Enforcement and Compliance Measures: The effectiveness of the California Department of Tax and Fee Administration (CDTFA) in administering and enforcing the tax would also be crucial in minimizing the tax gap. If robust mechanisms are put in place to ensure compliance and detect evasion, the tax gap could be minimized. The bill does not provide explicit details on compliance measures, such as reporting requirements, audits, or penalties for non-compliance. Compliance measures are crucial to encourage taxpayers to pay the correct amount of tax and deter evasion. Clear compliance measures, coupled with effective enforcement, can help minimize the tax gap. The proposal seems to satisfy the principle of minimum tax gap as it provides a framework for the collection and enforcement of the tax on short-term rentals. However, enforcing a tax on short-term rentals can be challenging due to the diversity of local regulations, incomplete information, and the informal nature of some rentals. With a combination of information sharing, collaboration with rental platforms, outreach, penalties, incentives, data analytics, and collaboration with local governments could help improve compliance and reduce the tax gap. |
| Accountability to taxpayers – Do taxpayers have access | Several elements in California SB 584 seem to align with this principle: |
| to information on tax laws and their development, modification and purpose; is the information visible? | Specific Use of Funds: The bill clearly outlines that the revenues from the tax are to be deposited into the Laborforce Housing Fund and used for the creation of Laborforce Housing and related projects. This specificity provides transparency about how the tax revenue will be used. |
| | Oversight of Funds: The fact that the funds are managed by the Department of Housing and Community Development could contribute to accountability, assuming that there is adequate oversight and reporting on how the funds are spent. |
| | Reasoning for Using Funds for Housing: The bill does not provide a detailed explanation of why these funds are specifically allocated to the housing fund. However, the focus on laborforce housing may be intended to address housing affordability and accessibility challenges faced by households with low or moderate incomes. By directing tax revenue from short-term rentals to laborforce housing, the bill may aim to address housing disparities and support equitable access to housing. |
| | The bill also does not explicitly explain why this particular tax was chosen over other funding mechanisms. The decision to tax short-term rentals at 15% may be based on the perceived impact of short-term rentals on housing availability and affordability or the desire to generate revenue from the growing short-term rental market. Policymakers may have determined that this tax aligns with the goal of supporting Laborforce housing. However, a more comprehensive explanation and justification for this tax choice would enhance accountability to taxpayers. |
| Appropriate government revenues – will the government be able to determine how much tax revenue will likely be collected and when? | Revenue Generation: The bill introduces a new 15% tax on short-term rentals, which could generate significant revenues. The size of the short-term rental market in California is substantial, and if the tax is effectively administered and collected, it could provide a meaningful source of revenue. |
| | Specific Use of Funds: The bill clearly states that the generated revenue will be used for the Laborforce Housing Fund, which finances housing projects for residents and households unable to afford market rent. This aligns the generation of revenue with a specific governmental responsibility—providing affordable housing. |
The proposal seems to satisfy the principle of appropriate government revenues. However, SB 584 earmarks the tax revenue from short-term rentals for the Laborforce Housing Fund. While earmarking can help ensure that funds are used for their intended purposes, it may also reduce budgetary flexibility. If the revenue generated by the tax exceeds the needs of the housing fund, it may result in an accumulation of unused funds. Conversely, if the tax revenue falls short, it may be challenging to find alternative funding sources for the housing projects. Policymakers should consider the potential risks and benefits of earmarking and whether it aligns with broader budgetary and policy priorities.

The above analysis shows that the California SB 584, or the "Short Term Rental" bill meets most of the twelve good tax policy principles. The proposal fails to meet principles of effective tax administration, simplicity and neutrality.

Overall, while the bill makes attempts to align with the principles of good tax policy, its effectiveness will depend largely on its implementation and the balance it strikes among competing interests. The potentially different impacts on various stakeholders, such as renters, operators, and housing beneficiaries, as well as the administrative capacity of the government, should be considered for a comprehensive understanding of its alignment with good tax policy principles. As always, in-depth policy analysis should involve consultation with experts and thorough consideration of the specific context and relevant data.

Some modifications of the bill can be made to meet principles of effective tax administration, simplicity and neutrality:

- Offer resources, support, and education to facilitators and operators to help them understand and fulfill their tax collection and remittance responsibilities.
- Ensure that the process for remitting the tax to the state is as straightforward as possible, which will reduce administrative burden for facilitators and operators. This might involve creating an online portal or system specifically for this purpose.
- Simplify the language and definitions within the bill as much as possible. The more clearly defined and understandable the language, the easier the bill will be to administer and comply with.
- Consider adjusting the tax rate or providing exemptions for certain types of short-term rentals to minimize distortions to the market. The current flat rate might disproportionately affect lower-priced rentals, potentially discouraging them.
- If possible, structure the tax collection process so that it doesn't unduly burden any specific group (like individual homeowners or small facilitators) more than others.
• Establish partnerships with major short-term rental platforms like Airbnb, VRBO, and Booking.com. These platforms can share data about rental listings, operators, and transaction volumes, helping the CDTFA identify operators who should be collecting the tax. This can improve compliance and reduce administrative burdens for both the state and operators.

• Local governments often have their own Transient Occupancy Taxes (TOTs) and business license requirements for short-term rentals. The CDTFA can work with local governments to share information on registered short-term rental operators and any taxes they've collected.

• Reimbursing or providing incentives to short-term rental operators and facilitators for their efforts to collect and remit the tax may help mitigate the administrative burden and encourage compliance with the tax.

• Provide clear guidelines and resources for short-term rental operators and facilitators to understand their tax obligations and facilitate compliance.

• Even though it is unlikely that confidential data of renters would be required, it is important for operators and facilitators to be mindful of data privacy and security requirements when handling any personal information. This includes complying with applicable data protection laws and ensuring that personal data is stored and transmitted securely.
Will Tax Geeks Be Replaced with AI?

By: Tom He, CPA, MST Student

Artificial intelligence is a hot topic nowadays. Emerging disruptive technology such as Generative AI, Machine learning and ChatGPT are catching the headlines. Different people have different thoughts about AI. Some consider it as a powerful tool to improve human work; while others are afraid that it will one day replace humans completely. For serious tax professionals, we are also curious about it. How is AI going to impact my day-to-day work? What can I do to stay competitive and keep my job? The speakers, Marc Borella, Program manager at IRS; Justin Femmer, Partner at PwC; Howard Schneck, President at Silicon Valley TEI Chapter and Director, Corporate Tax & Senior Tax Counsel, M&A, Varian Medical Systems; and Travis Thompson, Associate at Sideman & Bancroft LLP, participated in the 39th Annual TEI/SJSU High Tech Tax Institute on November 6th, 2023, to discuss AI and these exciting questions.

Recent AI developments

Mr. Thompson started the conversation by introducing his definition of AI. He mentioned that AI can be simply defined as “Machines acting in ways that seem intelligent”. Mr. Thompson mentioned that there are two types of AI. The first one is called Narrow AI and the second one is called General AI. Narrow AI is a machine or system that is designed to address a specific problem; while General AI is a machine or system that can solve various problems like human. As for our current technology capabilities, we are at the stage of Narrow AI. Although it is called “narrow”, Narrow AI is doing things that people couldn’t imagine before. For example, it gets a bar exam score of 298 (90%), SAT score of 1410 (>90%), GRE score of 99%. Because of its huge potential market value, a lot of tech companies are investing billions of dollars in AI developments. For example, Microsoft invested $10B in OpenAI; Google has released Bard for consumers; and Apple CEO announced $3.12 billion spent this year on R&D.

AI use cases on the tax field

Mr. Borella is a program manager at IRS. At the event, he shared some use cases on how AI and technology is helping IRS tax agents on their day-to-day work. One of the use cases Mr Borella shared is the use of large corporate compliance (LCC) and large partnership compliance (LPC) programs. These programs use data analytics to identify potential noncompliance of large corporate taxpayers. For tax auditors, there are tons of tax returns to audit every year. However, one tax auditor only has so much time in one tax season. How can he do the best of his job within a short period of time? The LCC and LPC program helps tax auditors with the selection of tax returns to audit by only picking out the ones with high-risk errors. With the help of this technology, the IRS tax auditors are working more efficiently, because they can focus their time and attentions on the higher risk returns.
Mr. Femmer is a partner at PwC. He shared some use cases on how public accounting firms are using AI and technologies. One of the technologies Mr. Femmer mentioned is the M&A due diligence tool. It is a tool that can quickly scan and summarize large volumes of documents. For M&A specialists, they must scan tons of documents for their due diligence work to provide the best advice to their clients. It could take them days and nights to read all the documents. With the help of the M&A due diligence AI or technology tool, they are able to scan all the relevant documentation quickly and focus more on the strategic planning and client consulting part of their work.

What tax professionals should do with AI?

Mr. Thompson mentioned that AI will change the way people work in the tax field. To get the most out of AI, tax professionals should stay up to date on the recent technology developments and try to implement new technologies with their team. At the same time, tax professionals should keep in mind that they should always keep updated and stay compliant with the AI guidelines not only from the government but also from their own organizations. Mr. Femmer mentioned that AI is a tool to assist tax professionals after all; therefore, as a responsible tax specialist, we should be responsible for our own work and keep the best of our professional standards.
The 39th Annual TEI-SJSU High Tech Tax Institute Conference on Nov 6 – 7, 2023

Transparency Reporting Readiness under Corporate Transparency Act

By: Aizhan Toibazarova, MST Student

A roundtable discussion panel convened at the TEI/SJSU High Tech Tax Institute conference on November 6 and 7 covered the intricacies of a new rule for reporting Beneficial Ownership Information (BOI) under the Corporate Transparency Act (CTA) enacted in 2021. The CTA was established to strengthen law enforcement initiatives to protect U.S. national security and the financial system while aligning with global efforts to combat anti-money laundering and countering illicit activities. The panel was led by Jonathan Dixon, Senior Advisor at the Financial Crimes Enforcement Network (FinCEN); Joe Fernandez, Partner at the Seiler LLP; and Elizabeth McMorrow, a seasoned tax attorney serving both domestic and international clients.

The panel commenced with Mr. Dixon covering details on filing requirements, due dates, exempted entities, and repercussions for non-compliance. Starting January 1, 2024, most small businesses structured as corporations, limited liability companies, or entities established through filing with secretary of state or similar office, are mandated to report BOI to FinCEN. Foreign companies registered to do business in the U.S. by filing of a document with a secretary of state or similar office are also subject to reporting. The legislation delineates 23 exempt categories, including publicly traded corporations, tax-exempt entities, financial institutions, brokerage, accounting, and venture firms, all of which already adhere to some form of ownership information reporting standards.

BOI reporting necessitates businesses to identify individuals who directly or indirectly own or control at least 25 percent of the ownership interests in a reporting company or exercises substantial control over it. Furthermore, for businesses formed after January 1, 2024, detailed information about company applicants must be reported. This includes their full legal name, date of birth, address, and identifying number and issuing jurisdiction of acceptable identification document (driver’s license or passport). Notably, an image of the document must also be submitted in compliance with the reporting obligations.

Mr. Fernandez’s presentation focused on the legal aspects of advising clients on CTA compliance. Unlike income tax returns governed by Title 26 of the Code, CTA falls under Title 31, the Criminal Code. The key concern in BOI reporting is the status of the form as a legal document. This raises questions about potential unauthorized law practice when CPAs and other non-attorney tax practitioners guide clients on BOI filing obligations, deadlines, as well as collecting, storing, and reporting this information.

Mr. Fernandez advised that CPA firms reach out to their malpractice insurance carriers and gain a comprehensive understanding of potential liabilities. Tax practitioners may face fees for breach
of professional conduct either by offering advice that treads the line of legality or deferring filing services endangering clients to non-compliance penalties.

As a prudent alternative, Mr. Fernandez recommended collaboration with law firms that can issue an engagement letter to CPA firms. This arrangement would enable tax practitioners to gather necessary information while mitigating legal risks. Additionally, Mr. Fernandez and Ms. McMorrow underscored the need for implementing a questionnaire and designing a process where clients promptly report any change in ownership or the beneficial owner’s information, given that FinCEN requires updates within 30 days of such changes.

Ms. McMorrow, who operates her own practice in Boston, offered guidance to law firms in preparation for reporting. She stressed the importance of CTA internal preparations, including drafting policies, categorizing entities as subject to reporting or exempt, and training relevant employees. CTA external preparations should focus on advising clients, auditing current client data, collecting missing data on ownership and non-U.S. clients established structures, and ensuring timely updates to FinCEN.

Ms. McMorrow also highlighted the importance of proper personnel training. The law requires reporting of a company applicants for businesses established on or after January 1, 2024. Since law firms often aid in the business registration process, their staff may qualify as company applicants subject to FINCEN reporting. Therefore, it is essential to provide personnel training to ensure they understand the implications of being an applicant for the company, considering that not all employees may willingly consent to the reporting of their personal data.

Given the uncertainties surrounding who will take on responsibility of informing, advising and assisting small businesses in filing the required information, there is a significant risk of non-compliance. Mr. Dixon stated that FinCEN is not adopting a punitive stance, recognizing the substantial effort required for successful implementation of this reporting. To support small businesses, FinCEN created a guide along with a comprehensive list of FAQs and videos to explain the reporting mandate in detail (https://www.fincen.gov/boi/small-entity-compliance-guide).

In summary, the discussion panel at the TEI/SJSU High Tech Institute conference highlighted the significant impact of reporting requirements for Beneficial Ownership Information (BOI) under the Corporate Transparency Act. As the implementation date of January 1, 2024, approaches, effective collaboration between accounting and law firms would assist collection of necessary information and ensure complete and timely reporting.
Hold the Dates

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