South-Western Federal Taxation 2017 Individual Income Taxes 40th edition Hoffman Solutions Manual

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CHAPTER 1

AN INTRODUCTION TO TAXATION AND UNDERSTANDING THE FEDERAL TAX LAW

SOLUTIONS TO PROBLEM MATERIALS

DISCUSSION QUESTIONS

1. (LO 1)
   a. By becoming a dealer, any gains and losses John has are converted from capital to ordinary classification.

   b. Theresa has become self-employed. Now she will be subject to self-employment tax and will have to make quarterly installment payments of estimated income and payroll taxes.

   c. Due to the home mortgage interest deduction and property tax deduction, most new home-owners will itemize their deductions *from* AGI. Thus, Paul probably will no longer claim the standard deduction on his income tax return.

2. (LO 1) The income tax consequences that result are Marvin's principal concern. Any rent he receives is taxed as income, but operating expenses and depreciation will generate deductions that offset some or all of the income or even yield a loss. Marvin must also consider the effect of other taxes. Because the property is being converted from residential to commercial use, he can expect an increase in the ad valorem property taxes levied by the local (and perhaps even the state) taxing authorities. Besides the real estate taxes, personal property taxes could be imposed on the furnishings.

3. (LO 2) The statement is only partly correct. The Federal income tax on corporations was not a problem as it had previously been sanctioned by the Supreme Court. What had been declared unconstitutional was the tax on individuals as it applied to the income *from property*.

4. (LO 2) To finance our participation in World War II, the scope of the income tax was expanded considerably—from a limited coverage of 6% to over 74% of the population. Hence, the description of the income tax as being a "mass tax" became appropriate.

5. (LO 2) For wage earners, the tax law requires employers to withhold a specified dollar amount from wages paid to the employee to cover income taxes and payroll taxes. Persons with nonwage income generally are required to make quarterly payments to the IRS for estimated taxes. Both procedures ensure that taxpayers will be financially able to meet their annual tax liabilities. That is, the amounts withheld are meant to prepay the employee's income taxes and payroll taxes related to the wages earned.

6. (LO 3) As to Adam Smith's canon on *economy*, the Federal income tax yields a mixed result. From the standpoint of the IRS, economy exists as collection costs are nominal (when compared with revenue generated). The government's cost of collecting Federal taxes amounts to less than one-half of 1 percent of the revenue collected. Economy is not present, however, if one looks to the compliance effort and costs expended by taxpayers. According to recent estimates, about 56% of individual taxpayers who file a return pay a preparer, and one-third purchase tax software.

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7. (LO 3) A tax is *proportional* if the rate of tax remains constant for any given income level. The tax is *progressive* if a higher rate of tax applies as the tax base increases.

8. (LO 4)
   a. The parsonage probably was not listed on the property tax rolls because it was owned by a tax-exempt church. Apparently, the taxing authorities are not aware that ownership has changed.

   b. Ethan should notify the authorities of his purchase. This will force him to pay back taxes but will eliminate *future* interest and penalties.

9. (LO 4) Although the Baker Motors bid is the lowest, from a long-term financial standpoint, it is the best. The proposed use of the property by the state and the church probably will make it exempt from the school district's ad valorem tax. This would hardly be the case with a car dealership. In fact, commercial properties (e.g., car dealerships) often are subject to higher tax rates.

10. (LO 4)
    a. In this case, the "tax holiday" probably concerns exemption from ad valorem taxes. "Generous" could involve an extended period of time (e.g., 10 years) and include both realty and personalty.

    b. The school district could be affected in two ways. First, due to the erosion of the tax base, less revenue would be forthcoming. Second, new workers would mean new families and more children to educate.

11. (LO 4) A possible explanation could be that Sophia made capital improvements (e.g., added a swimming pool) to her residence and her parents became retirees (e.g., reached age 65).

12. (LO 4) Presuming that the dockage facilities are comparable in Massachusetts, the Morgans may be trying to avoid ad valorem taxes. Taxes on nonbusiness personalty vary from one state to another and are frequently avoided.

13. (LO 4) Until recently, it appeared that Federal excise taxes had declined significantly as to the number of transactions covered. Taxes on the sale of jewelry, leather goods, cosmetics, and admission to entertainment events are no longer taxed by the Federal government. But the enactment of the gas guzzler tax and the tax on tanning salons, in addition to the increase in the tax on tobacco products, seems to indicate an expansion of excise taxes at the Federal level.

14. (LO 4) Herman could have been overcharged, but at least part of the excess probably is attributable to a hotel occupancy tax and a car rental tax. In major cities, these types of excise taxes have become a popular way of financing capital improvements such as sports arenas and stadiums. Consequently, the amount of the taxes could be significant.

15. (LO 4) An *excise tax* is limited to a particular transaction (e.g., sale of gasoline), while a general *sales tax* covers a multitude of transactions (e.g., sale of all nonfood goods).

    a. The following states *do not* impose a general sales tax: Alaska, Delaware, Montana, New Hampshire, and Oregon.

    b. There is no Federal general sales tax.

16. (LO 4)
    a. Jackson County must be in a state that imposes a lower (or *no*) sales tax. With certain major purchases (i.e., big-ticket items), any use tax imposed by the state of the Grays' residence could come into play.

    b. In some states, the sales tax rate varies depending on the county and/or city.

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17. (LO 4) Earl probably purchased his computer out of state through a catalog or via the Internet. In such cases, state collection of the sales (use) tax is not likely.

18. (LO 4) If the tax is imposed on the right to pass property at death, it is classified as an estate tax. If it taxes the right to receive property from a decedent, it is termed an inheritance tax.

    a. Some states impose both an estate tax and an inheritance tax. Some states (e.g., Florida and Texas) levy neither tax.

    b. The Federal government imposes an estate tax.

19. (LO 4) Jake either has a severe misunderstanding as to the rules regarding transfer taxes or is lying to Jessica to delay any parting with his wealth. The marital deduction allows interspousal transfers (whether by gift or at death) free of any tax (either gift or estate). There is no tax reason, therefore, in the case of spousal transfers to prefer transfers at death over lifetime gifts.

20. (LO 4)
    a. The purpose of the unified transfer tax credit is to eliminate the tax on all but substantial gifts and estates.

    b. Yes. The credit for 2016 is $2,125,800; for 2015, it is $2,117,800.

    c. Yes. The credit is available to cover transfers by gift or by death (or both), but the amount can be used only once.

21. (LO 4) $532,000. 19 donees (5 married children + 5 spouses + 9 grandchildren) × $14,000 (annual exclusion for 2016) × 2 donors (Elijah and Anastasia) = $532,000.

22. (LO 4) Both taxes are progressive in nature, but the corporate income tax does not make any distinction as to deductions—only business deductions are allowed. Nor does it require the computation of adjusted gross income (AGI) or provide for the standard deduction and personal and dependency exemptions.

23. (LO 4)
    a. For state income tax purposes, "piggyback" means making use of what was done for Federal income tax purposes. By "decoupling," a state decides not to allow a particular Federal provision (e.g., exclusion, deduction, credit) for state income tax purposes.

    b. A diminishing number of states allow a deduction for Federal income taxes paid.

    c. Most states allow their residents some form of tax credit for income taxes paid to other states.

24. (LO 4) What happened here likely is not a coincidence. The IRS probably notified the state of California regarding Hernando's omission of income. Thus, California followed up with its own audit.

25. (LO 4) If Mike is drafted by a team in one of the listed states, he will escape state income tax on income earned within that state (e.g., training camp, home games). He will not, however, escape the income tax (state and local) imposed by jurisdictions where he plays away games. Called the "jock tax," it is applied to out-of-state athletes and entertainers.

26. (LO 4, 5)
    a. This type of question has no relevance to the state income tax, but is a less than subtle way of encouraging taxpayers to pay any use tax due on Internet and mail-order purchases.

    b. As the preparer of the state income tax return, you should not leave questions unanswered unless there is a good reason for doing so. It appears that Harriet has no justifiable reason.

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27. (LO 4) The checkoff boxes add complexity to the return and mislead taxpayers into presuming that they are not paying for the donation.

28. (LO 4)
    a. They uncover taxpayers who were previously unknown to the taxing authority.

    b. Amnesty provisions can apply to other than income taxes (e.g., sales, franchise, severance).

    c. As of yet, no general amnesty program has been offered for the Federal income tax.

29. (LO 4)
    a. FICA offers some measure of retirement security, and FUTA provides a modest source of income in the event of loss of employment.

    b. FICA is imposed on both employer and employee, while FUTA is imposed only on the employer.

    c. FICA is administered by the Federal government. FUTA, however, is handled by both the Federal and state government.

    d. This applies only to FUTA. The merit system rewards employers who have low employee turnover, because this reduces the payout of unemployment benefits.

30. (LO 4)
    a. Unlike the Social Security portion of FICA, there is no dollar limit on the imposition of the Medicare tax.

    b. The .9% Medicare addition applies to taxpayers with wages or net self-employment income in excess of $200,000 ($250,000 for married filing jointly).

31. (LO 4) Only children under age 18 are excluded from FICA. Other family members, including spouses, must be covered.

32. (LO 4)
    a. Severance taxes are transaction taxes that are based on the notion that the state has an interest in its natural resources. The tax is imposed on the extraction of minerals.

    b. Franchise taxes are levied on the right to do business in the state. Typically, they are imposed on corporations and are based on their capitalization.

    c. Occupational fees are applicable to trades or businesses and are licenses to practice. Most are not significant revenue producers, and the amounts collected are utilized to defray the cost of regulating the profession.

    d. Customs duties are taxes on the importation of certain foreign goods. They are imposed by the Federal government and are not found at the state and local level.

    e. Export duties are taxes imposed on the export of certain commodities (e.g., oil, coffee). They are common to less-developed nations and are not levied by the United States.

33. (LO 4)
    a. The United States is the only country in the OECD (Organization of Economic Cooperation and Development) that does not have a value added tax (VAT). Approximately 80 countries use a VAT. In spite of its extensive use by other countries, the adoption of a VAT by the United States appears doubtful. Instead, the U.S. places high reliance on the income tax as its major revenue source.

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b. A VAT taxes the increment in value as goods move through the production and manufacturing stages to the marketplace. Although the tax is paid by the producer, it is reflected in the selling price of the goods. Therefore, a VAT is a tax on consumption.

c. Because it is an effective generator of revenue, the VAT has been criticized as leading to more government spending.

34. (LO 4)

a. Both the national sales tax and the VAT are taxes on consumption. Both taxes impose more of a burden on low-income taxpayers who must spend a larger proportion of their incomes on essential purchases. Thus, the taxes are regressive in effect.

b. At least in the case of a national sales tax, the regressive effect might be partly remedied by granting some sort of credit, rebate, or exemption to low-income taxpayers.

35. (LO 4, 5)

a. Due to the location of the business and the fact that the employees are "itinerant," Serena may be hiring undocumented aliens. Needless to say, this could cause serious nontax problems involving employment and immigration laws. As to tax problems, is Serena complying with the FICA and income tax withholding rules? Because of the high labor turnover Serena probably has, FUTA costs could be severe.

b. Very high. First, Serena is self-employed. Second, she operates on a cash basis. Third, the opportunity to understate income and/or overstate expenses is extremely high.

36. (LO 5)

a. A correspondence audit is probably involved. These audits involve a limited number of issues (i.e., taxpayer failed to report some dividend income) and most often are easily resolved.

b. What is described is an office audit.

c. The revenue agent's report (RAR) accepts the taxpayer's return as filed.

d. When a special agent becomes involved, this usually means that fraud is suspected.

37. (LO 5) In many unresolved audit disagreements at the agent level, the taxpayer should consider an appeal to the Appeals Division. Although it is part of the IRS, it is authorized to resolve audit disputes. It has greater settlement authority than does the agent. In many cases, a compromise reached at the Appeals Division can avoid a costly and time-consuming judicial proceeding.

38. (LO 5) The purpose of a statute of limitations is to preclude parties from prosecuting stale claims. The passage of time makes the defense of such claims difficult because witnesses and other evidence may no longer be available. In the Federal tax area, statutes of limitations cover additional assessments by the IRS and the pursuit of refund claims by taxpayers.

39. (LO 5)

a. The normal three-year statute of limitations will begin to run on April 15, 2016. When the return is filed early, the regular filing date controls.

b. Now the statute of limitations starts to run on the filing date. If the date of filing controlled (see part a. above), the taxpayer could shorten the assessment period by filing late.

c. If a return that is due is not filed, the statute of limitations does not start to run. It does not matter that the failure to file was due to an innocent error on the part of the taxpayer or adviser.

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d. Regardless of the fact that an innocent misunderstanding was involved, there is no statute of limitations when a return is not filed.

40. (LO 5) No. Interest is not paid if the refund is made within 45 days of when the return was filed. However, a return is not considered filed until its due date. Thus, the period from April 15 to May 28 does not satisfy the 45-day requirement.

41. (LO 5, 6)

a. Normally, the three-year statute of limitations applies to additional assessments the IRS can make. However, if a substantial omission from gross income is made, the statute of limitations is increased to six years. A substantial omission is defined as omitting in excess of 25% of the gross income reported on the return.

b. No, it would not. The proper procedure would be to advise Andy to disclose the omission to the IRS. Absent the client's consent, do not make the disclosure yourself.

c. If Andy refuses to make the disclosure and the omission has a material carryover effect to the current year, you should withdraw from the engagement.

42. (LO 5) $4,000, determined as follows:

Failure to pay penalty [.5% × $40,000 × 2 months]		$ 400
Plus:		
Failure to file penalty [5% × $40,000 × 2 months]	$4,000	
Less failure to pay penalty for the same period	(400)	3,600
Total penalties		$4,000

43. (LO 5)

a. $100,000 (20% × $500,000).

b. $375,000 (75% × $500,000). The answer presumes that civil (not criminal) fraud is involved.

44. (LO 5, 6)

a. No. Because no return was filed, the statute of limitations never runs. But even if a return had been filed, the three-year period for the 2012 tax return would not expire until April 15, 2016, three years after the normal due date for filing.

b. Although you can only recommend that the return be filed, you cannot force him to do so. However, you should not undertake the engagement for 2013 through 2015 if you cannot correctly reflect the tax liability due to the omission for 2012.

45. (LO 5, 6) The practice of outsourcing the preparation of tax returns is ethical if three steps are taken.

- Maintain client confidentiality.
- Verify the accuracy of the work done.
- Notify the client, preferably in writing, of the outsourcing.

46. (LO 7)

a. This is the ideal approach to handling a tax cut—for every dollar lost, a new dollar is gained.

b. Pay-as-you-go is another way of describing revenue neutrality. Thus, tax cuts should not result in an overall loss of revenue.

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c. All the sunset provision does is reinstate the law as it existed prior to the tax cut. Here, the possibility exists that Congress will rescind (or postpone) the sunset provision before it takes effect.

d. Indexation is a procedure whereby the IRS makes annual adjustments to certain key tax components to take into account inflation. Some of the more important components that are adjusted include tax brackets, standard deduction, and personal and dependency exemptions.

47. (LO 7)

a. To encourage pension plans is to stimulate saving (economic consideration). Also, it provides security from the private sector for retirement to supplement rather meager public programs (social considerations).

b. To make education more widely available is to promote a socially desirable objective. A better educated workforce also serves to improve the country's economic capabilities. Thus, education tax incentives can be justified on both social and economic grounds.

c. The encouragement of home ownership can be justified on both social and economic grounds.

48. (LO 7, 8)

a. Social considerations explain the credit. It is socially desirable to encourage parents to provide care for their children while they work.

b. These deductions raise the issue of preferential tax treatment for homeowners—taxpayers who rent their personal residences do not receive comparable treatment. Even so, the encouragement of home ownership can be justified on economic and social grounds.

c. The joint return procedure came about to equalize the position of married persons living in common law states with those residing in community property jurisdictions. Political and equity considerations caused this result.

d. Social considerations dictate that the tax law should not be used to encourage certain activities that are deemed to be contrary to public policy.

e. The NOL carryback provision is an equity consideration that is designed to mitigate the effect of the annual accounting period concept.

f. The installment method of reporting gain is consistent with the wherewithal to pay concept—the seller is taxed when the payments are made by the purchaser.

g. The exclusion from Federal income taxation of interest from state and local bonds can be justified largely on political considerations. Political goodwill is generated by allowing state and local jurisdictions to secure financing at a lower cost (i.e., interest rate) due to favorable Federal income tax treatment.

h. The treatment of prepaid income is justified under the wherewithal to pay concept. It also eases the task of the IRS as to administration of the tax law.

49. (LO 7)

a. Mia's realized gain from the condemnation is $320,000 [$400,000 (amount of award) − $80,000 (cost basis of the warehouse)]. However, her recognized gain is limited to $120,000—the amount received that was not reinvested.

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b. None of the gain is recognized because Mia reinvested the full amount of the condemnation award.

c. As none of the gain was reinvested, the full $320,000 is recognized as income.

d. The involuntary conversion provision can be justified under the wherewithal to pay concept and the notion that the taxpayer's economic position has not changed. In part b., for example, Mia has retained none of the award and has reinvested in property similar to that taken by the city.

50. (LO 8) If the collection is worth more than $1,000, the mother has probably made a gift of the excess value to the daughter. Quite possibly the transaction could result in the imposition of a gift tax. Sales or other transactions between related parties are subject to the arm's length test. In this case, for example, would the mother have made this sale for $1,000 if the purchaser had been an unrelated third party?

SOLUTION TO ETHICS & EQUITY FEATURE

Making Good Use of Out-of-State Relatives (p. 1-10). Who is the true purchaser of the bracelet? If the aunt really made the purchase with her funds and then gave the bracelet to Marcus, no sales or use tax evasion has occurred. More likely, the purchase was made by Marcus indirectly through his aunt—the aunt being reimbursed by Marcus or using funds provided by him. If such is the case, Marcus owes a sales tax on the purchase. Presuming the matter comes to light—the jewelry store might be the weak link—Marcus could be subject to prosecution for tax evasion.

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CHAPTER 2

WORKING WITH THE TAX LAW

SOLUTIONS TO PROBLEM MATERIALS

DISCUSSION QUESTIONS

1. (LO 1) Determining the intent of Congress is a large part of tax research.

2. (LO 1) The many gray areas, the complexity of the tax laws, and the possibility for different interpretations of the tax law create the necessity of alternatives for structuring a business transaction.

3. (LO 1) Federal tax legislation generally originates in the House Ways and Means Committee.

4. (LO 2, 5) Hoffman, Young, Raabe, Maloney, & Nellen, CPAs
5191 Natorp Boulevard
Mason, OH 45040

   March 25, 2016

   Mr. Butch Bishop
   Tile, Inc.
   100 International Drive
   Tampa, Florida 33620

   Dear Mr. Bishop:

   This letter is in response to your request about information concerning a conflict between a U.S. treaty with Spain and a section of the Internal Revenue Code. The major reason for treaties between the United States and certain foreign countries is to eliminate double taxation and to render mutual assistance in tax enforcement.

   Section 7852(d) provides that if a U.S. treaty is in conflict with a provision in the Code, neither will take general precedence. Rather, the more recent of the two will have precedence. In your case, the Spanish treaty takes precedence over the Code section.

   A taxpayer must disclose on the tax return any positions where a treaty overrides a tax law. There is a $1,000 penalty per failure to disclose for individuals and a $10,000 penalty per failure for corporations.

   Should you need more information, feel free to contact me.

   Sincerely,

   Alice Hanks, CPA
   Tax Partner

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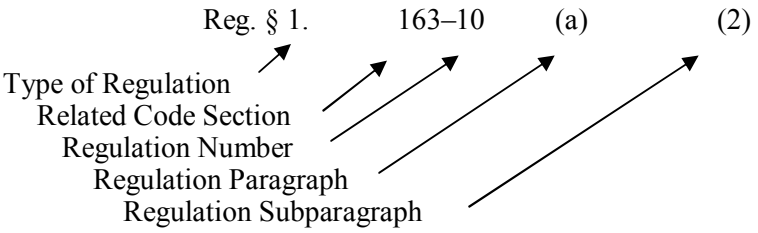
5. (LO 1, 2) Income tax



6. (LO 1) Notice 90–20 is the 20th Notice issued during 1990, and it appears on page 328 of Volume 1 of the *Cumulative Bulletin* in 1990.

7. (LO 1, 4) The items would probably be ranked as follows (from lowest to highest):

(1) Letter ruling (valid only to the taxpayer to whom issued).

(2) Proposed Regulation (most courts ignore these).

(3) Revenue Ruling.

(4) Interpretive Regulation.

(5) Legislative Regulation.

(6) Internal Revenue Code.

8. (LO 1)

a. This is a Temporary Regulation; 1 refers to the type of Regulation (i.e., income tax), 956 is the related Code section number, 2 is the Regulation section number, and T refers to temporary.

b. Revenue Ruling number 15, appearing on page 975 of the 23rd weekly issue of the *Internal Revenue Bulletin* for 2012.

c. Letter Ruling 51, issued in the 4th week of 2002.

9. (LO 1, 5) TAX FILE MEMORANDUM

DATE: September 23, 2016

FROM: George Ames

SUBJECT: Telephone conversation with Sally Andrews on applicability of 2007 letter ruling

I told Sally Andrews that only the taxpayer to whom the 2007 letter ruling was issued may rely on the pronouncement. I stressed that a letter ruling has no precedential value under § 6110(k)(3).

I pointed out that a letter ruling indicates the position of the IRS on the specific fact pattern present as of the date of the letter ruling. As such, a letter ruling is not primary authority. However, under Notice 90–20, 1990–1 C.B. 328, a letter ruling is substantial authority for purposes of the accuracy-related penalty in § 6662.

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10. (LO 1) Sri should consider the following factors in determining whether he should request a letter ruling from the IRS with respect to the proposed stock redemption:

- For a fee, the IRS will issue a letter ruling at a taxpayer's request and describe how the IRS will treat a proposed transaction. The letter ruling applies only to the requesting taxpayer. A Revenue Ruling is applicable to all taxpayers.
- Sri must determine whether the possible tax amount is large enough to warrant the costs and time to apply for a letter ruling. Here, the tax issue is probably important enough to do so.
- If Sri is likely to obtain an adverse letter ruling from the National Office, he should forgo the ruling request.
- The letter ruling would have substantial authority for purposes of the accuracy-related penalty.
- Sri needs to consult Rev.Proc. 2016–3 to be certain the IRS will issue a ruling about this tax issue. The IRS will not rule in certain areas that involve fact-oriented situations, but will probably issue one here.

11. (LO 1) Letter rulings may be found in:

- Private Letter Rulings (RIA).
- BNA Daily Tax Reports.
- Tax Notes (Tax Analysts).
- Although not referenced in the text, letter rulings are also available in the IRS Letter Rulings Report (CCH).

12. (LO 1) TEAMs are issued by the Office of Chief Counsel to expedite legal guidance to field agents as disputes are developing. TEAMs differ from TAMs as follows:

- A mandatory presubmission conference involves the taxpayer.
- In the event of a tentatively adverse conclusion to the taxpayer or to the field agent, a conference of right will be offered to the taxpayer and to the field agent.
- No further conferences are offered once the conference of right is held.

13. (LO 1) Dwain must consider several factors in deciding whether to take the dispute to the judicial system:

- How expensive will it be?
- How much time will be consumed?
- Does he have the temperament to engage in the battle?
- What is the probability of winning?
- Once a decision is made to litigate the issue, the appropriate judicial forum must be selected.
- Tax Court judges have more expertise in tax matters.

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- The tax deficiency need not be paid to litigate in the Tax Court. However, if Dwain loses, interest must be paid on any unpaid deficiency.
- If a trial by jury is preferred, the U.S. District Court is the appropriate forum.
- The tax deficiency must be paid before litigating in the District Court or the Court of Federal Claims.
- If an appeal to the Federal Circuit is important, Dwain should select the Court of Federal Claims.
- A survey of the decisions involving the issues in dispute is appropriate. If a particular court has taken an unfavorable position, that court should be avoided.

14. (LO 1) The main advantage of the U.S. Court of Federal Claims occurs when a taxpayer's applicable Circuit Court previously rendered an adverse decision. Such a taxpayer may select the U.S. Court of Federal Claims because any appeal will be to the Federal Circuit.

One disadvantage of the U.S. Court of Federal Claims is that the tentative deficiency must be paid before the Court will hear and decide the controversy.

The U.S. Court of Federal Claims is a trial court that usually meets in Washington, D.C. It has jurisdiction for any claim against the United States that is based on the Constitution, any Act of Congress, or any Regulation of an executive department.

15. (LO 1, 5) Hoffman, Young, Raabe, Maloney, & Nellen, CPAs
5191 Natorp Boulevard
Mason, OH 45040

July 8, 2016

Mr. Eddy Falls
200 Mesa Drive
Tucson, AZ 85714

Dear Mr. Falls:

You have three alternatives should you decide to pursue your $229,030 deficiency in the court system. One alternative is the U.S. Tax Court, the most popular forum. Some people believe that the Tax Court judges have more expertise in tax matters. The main advantage is that the U.S. Tax Court is the only trial court where the tax need not be paid prior to litigating the controversy. However, interest will be due on an unpaid deficiency. The interest rate varies from one quarter to the next as announced by the IRS.

One disadvantage of the U.S. Tax Court is the delay that might result before a case is decided. The length of delay depends on the Court calendar, which includes a schedule of locations where cases will be tried. Another disadvantage is being unable to have the case heard before a jury.

The major advantage of another alternative, the U.S. District Court, is the availability of a trial by jury. One disadvantage of a U.S. District Court is that the tentative tax deficiency must be paid before the Court will hear and decide the controversy.

The Court of Federal Claims, the third alternative, is a trial court that usually meets in Washington, D.C. It has jurisdiction for any claim against the United States that is based on the Constitution, any Act of Congress, or any regulation of an executive department. The main advantage of the U.S. Court of Federal Claims occurs when a taxpayer's applicable Circuit Court previously rendered an adverse

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decision. Such a taxpayer may select the Court of Federal Claims because any appeal will be to the Federal Circuit instead. One disadvantage of the Court of Federal Claims is that the tentative deficiency must be paid before the Court will hear and decide the controversy.

I hope this information is helpful, and should you need more help, please contact me.

Sincerely,

Agnes Reynolds, CPA
Tax Partner

16. (LO 1) The U.S. Tax Court hears only tax cases and is the most popular forum for tax cases (generally viewed as an advantage). Some people suggest that the Tax Court has more expertise in tax matters. A taxpayer does not have to pay the tax deficiency assessed by the IRS before trial, but a taxpayer may deposit a cash bond to stop the running of interest (also viewed as an advantage). Appeals from a Tax Court are to the appropriate U.S. Court of Appeals. A disadvantage is that the taxpayer may not obtain a jury trial in the U.S. Tax Court.

17. (LO 1) See Exhibit 2.4, Exhibit 2.5, and Concept Summary 2.1.

    a. There is no appeal by either the taxpayer or the IRS from a decision of the Small Cases Division of the U.S. Tax Court.

    b. The first appeal would be to the Sixth Circuit Court of Appeals. Further appeal would be to the U.S. Supreme Court.

    c. Same as b. above.

    d. The appeal would be to the Federal Circuit Court of Appeals and then to the U.S. Supreme Court.

18. (LO 1) The term *petitioner* is a synonym for plaintiff, which refers to the party requesting action in a court.

19. (LO 1) Both the Code and the Supreme Court indicate that the Federal appellate courts are bound by findings of facts unless they are clearly erroneous. Thus, the *role* of appellate courts is limited to a review of the record of trial compiled by the trial courts. Therefore, the appellate process usually involves a determination of whether the trial court applied the proper law in arriving at its decision. Rarely will an appellate court disturb a lower court's fact-finding determination.

20. (LO 1) See Concept Summary 2.1.

		U.S. Tax Court	U.S. District Court	U.S. Court of Federal Claims
a.	Number of regular judges	19	Varies; one judge hears a case	16
b.	Jury trial	No	Yes	No
c.	Prepayment of deficiency required before trial	No	Yes	Yes

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21. (LO 1) See Exhibit 2.5.

a. Tenth

b. Eighth

c. Ninth

d. Fifth

e. Seventh

22. (LO 1) See Exhibit 2.4.

a. The Tax Court must follow its own cases, the pertinent U.S. Circuit Court of Appeals, and the Supreme Court.

b. The Court of Federal Claims must follow its own decisions, the Federal Circuit Court of Appeals, and the Supreme Court.

c. The District Court must follow its own decisions, the pertinent U.S. Circuit Court of Appeals, and the Supreme Court.

23. (LO 1) The appropriate Circuit Court of Appeals for an appeal depends on where the litigation originated. For example, an appeal from Texas would go to the Fifth Circuit Court of Appeals and an appeal from Colorado would go to the Tenth Circuit Court of Appeals. See Exhibit 2.5.

24. (LO 1, 4)

a. If the taxpayer chooses a U.S. District Court as the trial court for litigation, the U.S. District Court of Wyoming will be the forum to hear the case. Unless the prior decision has been reversed on appeal, one would expect the same court to follow its earlier holding.

b. If the taxpayer chooses the U.S. Court of Federal Claims as the trial court for litigation, the decision that was rendered previously by this Court should have a direct bearing on the outcome. If the taxpayer selects a different trial court (i.e., the appropriate U.S. District Court or the U.S. Tax Court), the decision that was rendered by the U.S. Court of Federal Claims will be persuasive but not controlling. It is, of course, assumed that the result that was reached by the U.S. Court of Federal Claims was not reversed on appeal.

c. The decision of a U.S. Circuit Court of Appeals will carry more weight than will one that was rendered by a trial court. Because the taxpayer lives in California, however, any appeal from a U.S. District Court or the U.S. Tax Court will go to the Ninth Circuit Court of Appeals (see Exhibit 2.4). Although the Ninth Circuit Court of Appeals might be influenced by what the Second Circuit Court of Appeals has decided, it is not compelled to follow such holding. See Exhibit 2.5.

d. Because the U.S. Supreme Court is the highest appellate court, one can place complete reliance upon its decisions. Nevertheless, one should investigate any decision to see whether the Code has been modified with respect to the result that was reached. There also exists the rare possibility that the Court may have changed its position in a later decision. See Exhibit 2.4.

e. When the IRS acquiesces to a decision of the U.S. Tax Court, it agrees with the result that was reached. As long as such acquiescence remains in effect, taxpayers can be assured that this represents the position of the IRS on the issue that was involved. Keep in mind, however, that the IRS can change its mind and can, at any time, withdraw the acquiescence and substitute a nonacquiescence.

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f. The issuance of a nonacquiescence usually reflects that the IRS does not agree with the result that was reached by the U.S. Tax Court. Consequently, taxpayers are placed on notice that the IRS will continue to challenge the issue that was involved.

25. (LO 2) The number 66 is the volume number for the U.S. Tax Court, 39 refers to the page number of the 562nd volume of the *Federal Second Series*, and *nonacq.* means that the IRS disagreed with the decision. The Tax Court (T.C.) cite is to the trial court.

26. (LO 2) There is no automatic right of appeal to the U.S. Supreme Court. Appeal is by Writ of Certiorari. If the Court agrees to hear the dispute, it will grant the Writ (*Cert. granted*). Most often, the highest court will deny jurisdiction (*Cert. denied*).

27. (LO 2)

a. Ninth Circuit Court of Appeals.

b. U.S. Tax Court.

c. U.S. Supreme Court.

d. Bureau of Tax Appeal (old name of U.S. Tax Court).

e. Tax Court (memorandum decision).

f. Court of Claims.

g. Not a court decision.

h. District Court in New York.

i. Not a court decision.

28. (LO 2) See Concept Summary 2.2.

a. This citation is to a regular decision of the U.S. Tax Court that was issued in 1950. The decision can be found in Volume 14, page 74, of the *Tax Court of the United States Report*, published by the U.S. Government Printing Office.

b. This citation is for a decision of the U.S. Fifth Circuit Court of Appeals that was rendered in 1979. The decision can be found in Volume 592, page 1251, of the *Federal Reporter*, Second Series (F. 2d), published by West Publishing Company.

c. This citation is for a decision of the U.S. Sixth Circuit Court of Appeals that was rendered in 1995. The decision can be found in Volume 1 for 1995, paragraph 50,104 of *U.S. Tax Cases*, published by Commerce Clearing House.

d. This citation is for a decision of the U.S. Sixth Circuit Court of Appeals that was rendered in 1995. The decision can be found in Volume 75, page 110, of the *Second Series of American Federal Tax Reports*, published by RIA.

e. This citation is for a decision of the U.S. District Court of Texas that was rendered in 1963. The decision can be found in Volume 223, page 663, of the *Federal Supplement Series*, published by West Publishing Company.

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29. (LO 2)
    a. None.

    b. USTC.

    c. USTC.

    d. USTC.

    e. TCM.

30. (LO 2) Decisions of the U.S. Court of Federal Claims (formerly named the Claims Court) are published in the USTCs; AFTRs; and the West Publishing Co. reporter called the *Federal Reporter, Second Series* (F.2d) (before October 1982) and *Claims Court Reporter* (beginning October 1982 through October 30, 1992). The name of the U.S. Court of Federal Claims was changed from the Claims Court effective October 30, 1992. Currently, this court's decisions are published in the *Federal Claims Reporter*. See Concept Summary 2.2.

31. (LO 1, 2)
    a. Yes. Exhibit 2.3

    b. No. Not published there. Concept Summary 2.2

    c. No. Published by private publishers. Exhibit 2.3

    d. Yes. Exhibit 2.3

    e. Yes. Exhibit 2.3

    f. No. Concept Summary 2.2

    g. Yes. Exhibit 2.3

    h. No. Concept Summary 2.2

32. (LO 3) After understanding the relevant facts:

- Yvonne may begin with the index volumes of the available tax services: RIA, CCH, or BNA Portfolios.

- A key word search on an online service could be helpful—Westlaw (or WestlawNext), LexisNexis, CCH *IntelliConnect*, and Thomson Reuters *Checkpoint*.

- Yvonne may browse through IRS publications (available on the IRS website).

- Yvonne could consult CCH's *Federal Tax Articles* to locate current appropriate articles written about child support payments. Thomson Reuters publishes the *Index to Federal Tax Articles* that is organized using RIA's paragraph index system.

- Yvonne may consult The Accounting & Tax Index, which is available in three quarterly issues and a cumulative year-end volume covering all four quarters.

- Up-to-date information may be found on the Web. Various legal, accounting, and financial gateways can be found by clicking on highlighted words or phrases.

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33. (LO 4) The current Code can be found in various places. Several of the major tax services publish paperback editions of the Code (and Regulations). These editions are usually revised twice each year. An annotated and abridged version of the Code and Regulations is published annually by Cengage (by James E. Smith and Mark Altieri). Further, the text of the Code may be found in the major tax services and as Title 26 of the U.S. Code. The Code also may be found on the Web.

34. (LO 2, 4) The best means of locating tax articles pertinent to your problem is through Commerce Clearing House's *Federal Tax Articles*. This multivolume service includes a subject index, a Code section number index, and an author's index. Another is the *Index to Federal Tax Articles* (published by Thomson Reuters). Both of these indexes are updated periodically, but are available only in print form.

    Court decisions, revenue rulings and procedures, and other relevant authority may be reviewed for reliability by using a *citator* within the commercial tax service. A citator provides the history of a case, including the authority relied on (e.g., other judicial decisions) in reaching the result. Reviewing the references listed in the citator discloses whether the decision was appealed and, if so, with what result (e.g., affirmed, reversed, or remanded). It also reveals other cases with the same or similar issues and how they were decided. Thus, a citator reflects on the validity of a case and may lead to other relevant authority. If one intends to rely on a judicial decision to any significant degree, "running" the case through a citator is imperative.

35. (LO 6) The primary purpose of tax planning is to reduce a taxpayer's overall tax liability. This process can entail an avoidance, a reduction, or a postponement of the tax until the future.

    This process does not mean that the course of action selected must produce the lowest possible tax under the circumstances. Legitimate business goals also must be considered.

    There is nothing illegal or immoral about tax avoidance. A citizen has every legal right to arrange his or her affairs to keep the attendant taxes as low as possible. One is required to pay no more taxes than the law demands. There is no difference between a tax adviser's reduction of a tax expense and a cost accountant's reduction of a cost of operating a business.

36. (LO 7) Simulations on the CPA exam are small case studies designed to test a candidate's tax knowledge and skills using real-life work-related situations. Simulations include a four-function, pop-up calculator, a blank spreadsheet with some elementary functionality, and authoritative excerpts that are necessary to complete the tax case study simulations (e.g., Internal Revenue Code and Federal tax forms). The AICPA plans to make a number of changes to the CPA exam, including increasing the number of simulations, in 2017.

PROBLEMS

37. (LO 1)
    b. p. 2-5

38. (LO 1)
    b. Exhibit 2.3

39. (LO 1)
    d. Exhibit 2.3

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40. (LO 1, 4)
   a. Code section.
   b. Legislative Regulation.
   c. Recent Temporary Regulation.
   d. Interpretive Regulation.
   e. Revenue Ruling.
   f. Letter Ruling.
   g. Proposed Regulation.

41. (LO 4)
   a. P.
   b. P.
   c. P.
   d. S.
   e. P.
   f. S.
   g. P. Valid for three years.
   h. P.
   i. N.
   j P.

42. (LO 1, 2)
   a. CCH.
   b. RIA.
   c. U.S.
   d. CCH.
   e. U.S.
   f. RIA.
   g. W.
   h. W.
   i. W.
   j. W.
   k. U.S.
   l. O.

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43. (LO 6)
    a. E.
    b. E.
    c. A.
    d. A.
    e. A.

RESEARCH PROBLEMS

1. a. *Higgens v. Comm*., 312 U.S. 212 (1941).
   b. *Talen v. U.S.*, 355 F.Supp.2d 22 (D.Ct. D.C., D.D.C., 2004).
   c. Rev.Rul. 2008–18, 2008–13 I.R.B. 674.
   d. *Pahl v. Comm*., 150 F.3d 1124 (CA–9, 1998).
   e. *Veterinary Surgical Consultants PC*, 117 T.C. 141 (2001).
   f. *Yeagle Drywall Co*., T.C. Memo. 2001–284.

2. IRC § 7463(b) states that a decision entered into by any small case decision "shall not be reviewed in any other court and shall not be treated as precedent for any other case."

   In the reviewed opinion *Larry Mitchell* 131 T.C. 215 (2008), the court held that an ex-wife's share of military retirement payments is subject to tax. This same issue had been litigated previously by the taxpayer in *Mitchell*, T.C. Summ. 2004–160.

   In the past, the Tax Court has used collateral estoppel in small tax case decisions to stop (estop) a party from litigating the same issue in a regular Tax Court case. As a result, this reviewed decision seems to contradict their stance. Judge Holmes stated that this Tax Court decision means "that they are without effect on future litigation at all."

3. For the Oprah car giveaway, the 234 audience recipients who received keys to a car were taxed on the value of the car, which was in the $30,000 range. Because they were merely present in the audience, the fair market value was included in gross income under § 61.

   As for the World Furniture Mall promotion, the discount or rebate could be tax-free because a rebate of all or a portion of the purchase price of property generally does not result in gross income. The customer would have a zero basis in the furniture. Rev.Rul. 76–96, 1976–1 C.B. 23 and Rev.Rul. 88–95, 1988–2 C.B. 28. See "Furniture for Nothing and It's all Tax-Free," *Journal of Taxation*, December 2006, pp. 382 and 383.

4. There does not appear to be a clear-cut answer to this question. Section 104 allows exclusion from gross income for damages paid on account of physical injuries and physical sickness. However, the IRS requires observable bodily harm for an exclusion to be available (Ltr.Rul. 200041022).

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So is false imprisonment physical? In CCA 200809001, the IRS allowed an exclusion for a settlement with an institution for sexual abuse. However, the Tax Court in *Daniel and Brenda Stadnyk*, T.C. Memo. 2008–289 would not allow an exclusion for $49,000 received for about one day in a jail.

Brenda Stadnyk was dissatisfied with an automobile purchase, so she placed a stop payment order on the check she tendered to the dealership. Bank One listed the reason for not paying the dealership as a "NSF check." The dealership then filed a criminal complaint against her for passing a worthless check. She spent about one day in a holding area in a county jail.

In "Why False Imprisonment Recoveries Should Not Be Taxable," *Tax Notes*, June 8, 2009, pp. 1217–1220, Robert Wood provides a lengthy discussion of this problem.

Research Problems 5 and 6

The Internet Activity research problems require that students utilize online resources to research and answer the questions. As a result, solutions may vary among students and courses. You should determine the skill and experience levels of the students before assigning these problems, coaching where necessary. Encourage students to explore all parts of the Web in this research process, including tax research databases, as well as the websites of the IRS, newspapers, magazines, businesses, tax professionals, other government agencies, and political outlets. Students should also work with resources such as blogs, Twitter feeds, and other interest-oriented technologies to research their answers.

5. (1) Go to the website, click on the Internal Revenue Code link, click on Subtitle A, and scroll down to Sec. 61. This section defines gross income broadly. In addition to the 15 items specifically listed as income, Sec. 61 directs the reader to other IRC sections and indicates that the list of income items is not all-inclusive. In general, the IRC takes a broad view of income; everything is income unless an IRC section specifies that the amount is not income.

   (2) To find the case, go to the website and click on the US Tax Court link on the left side of the page. Enter the name Mark Spitz in the search bar.

      a. The tax years are 2001 and 2002, as indicated in the first sentence of the case, not 2006, the year in the citation, which is the year the case was decided.
      b. As noted above, 2006.
      c. The court decided in favor of the IRS.
      d. At the end of the decision, the penalty in Sec. 6662 is discussed. This section imposes a 20% accuracy-related penalty on any portion of a tax liability underpayment (the situation in which Mr. Spitz found himself) attributable to a substantial understatement of income tax. Mr. Spitz was found not liable for the penalty because the court indicated that he was unsophisticated in tax law and had relied on a competent adviser to prepare his return.

6. a. On the "Opinions Search" tab, review the "Opinion Type" choices.
   b./c. On the "Opinions Search" tab, select the appropriate opinion type and enter a common last name in the "Case Name Keyword" bar.
   d. Click on the Rules tab on the upper left side of the page.

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SOLUTION TO ETHICS & EQUITY FEATURE

Reporting Tax Fraud (p. 2-7). Most individuals probably believe that it is ethical to report tax fraud. A 2014 IRS Oversight Board survey indicated that 86 percent of Americans believed that it was "not acceptable at all to cheat on taxes." On the other hand, that same survey indicated that 11 percent of taxpayers said that some cheating on their taxes was acceptable.

A number of organizations (including the IRS) provide estimates of the "tax gap," with the most recent estimates indicating that between $300 and $400 billion of unpaid taxes exist each year. These unpaid taxes increase the taxes of honest taxpayers. In fiscal year 2014, the IRS collected $57.2 billion in enforcement revenue.

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NOTES

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CHAPTER 2

WORKING WITH THE TAX LAW

SOLUTIONS TO PROBLEM MATERIALS

DISCUSSION QUESTIONS

1. (LO 1) Determining the intent of Congress is a large part of tax research.

2. (LO 1) The many gray areas, the complexity of the tax laws, and the possibility for different interpretations of the tax law create the necessity of alternatives for structuring a business transaction.

3. (LO 1) Federal tax legislation generally originates in the House Ways and Means Committee.

4. (LO 2, 5) Hoffman, Young, Raabe, Maloney, & Nellen, CPAs
5191 Natorp Boulevard
Mason, OH 45040

   March 25, 2016

   Mr. Butch Bishop
   Tile, Inc.
   100 International Drive
   Tampa, Florida 33620

   Dear Mr. Bishop:

   This letter is in response to your request about information concerning a conflict between a U.S. treaty with Spain and a section of the Internal Revenue Code. The major reason for treaties between the United States and certain foreign countries is to eliminate double taxation and to render mutual assistance in tax enforcement.

   Section 7852(d) provides that if a U.S. treaty is in conflict with a provision in the Code, neither will take general precedence. Rather, the more recent of the two will have precedence. In your case, the Spanish treaty takes precedence over the Code section.

   A taxpayer must disclose on the tax return any positions where a treaty overrides a tax law. There is a $1,000 penalty per failure to disclose for individuals and a $10,000 penalty per failure for corporations.

   Should you need more information, feel free to contact me.

   Sincerely,

   Alice Hanks, CPA
   Tax Partner

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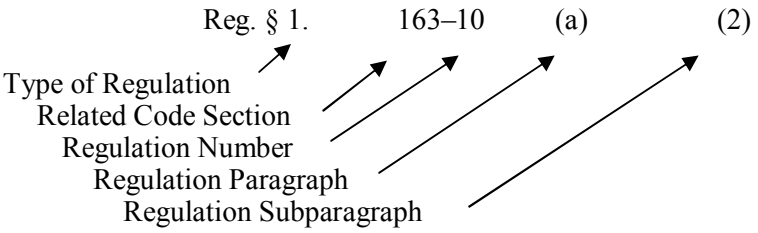
5. (LO 1, 2) Income tax



6. (LO 1) Notice 90–20 is the 20th Notice issued during 1990, and it appears on page 328 of Volume 1 of the *Cumulative Bulletin* in 1990.

7. (LO 1, 4) The items would probably be ranked as follows (from lowest to highest):

(1) Letter ruling (valid only to the taxpayer to whom issued).

(2) Proposed Regulation (most courts ignore these).

(3) Revenue Ruling.

(4) Interpretive Regulation.

(5) Legislative Regulation.

(6) Internal Revenue Code.

8. (LO 1)

a. This is a Temporary Regulation; 1 refers to the type of Regulation (i.e., income tax), 956 is the related Code section number, 2 is the Regulation section number, and T refers to temporary.

b. Revenue Ruling number 15, appearing on page 975 of the 23rd weekly issue of the *Internal Revenue Bulletin* for 2012.

c. Letter Ruling 51, issued in the 4th week of 2002.

9. (LO 1, 5) TAX FILE MEMORANDUM

DATE: September 23, 2016

FROM: George Ames

SUBJECT: Telephone conversation with Sally Andrews on applicability of 2007 letter ruling

I told Sally Andrews that only the taxpayer to whom the 2007 letter ruling was issued may rely on the pronouncement. I stressed that a letter ruling has no precedential value under § 6110(k)(3).

I pointed out that a letter ruling indicates the position of the IRS on the specific fact pattern present as of the date of the letter ruling. As such, a letter ruling is not primary authority. However, under Notice 90–20, 1990–1 C.B. 328, a letter ruling is substantial authority for purposes of the accuracy-related penalty in § 6662.

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10. (LO 1) Sri should consider the following factors in determining whether he should request a letter ruling from the IRS with respect to the proposed stock redemption:

- For a fee, the IRS will issue a letter ruling at a taxpayer's request and describe how the IRS will treat a proposed transaction. The letter ruling applies only to the requesting taxpayer. A Revenue Ruling is applicable to all taxpayers.
- Sri must determine whether the possible tax amount is large enough to warrant the costs and time to apply for a letter ruling. Here, the tax issue is probably important enough to do so.
- If Sri is likely to obtain an adverse letter ruling from the National Office, he should forgo the ruling request.
- The letter ruling would have substantial authority for purposes of the accuracy-related penalty.
- Sri needs to consult Rev.Proc. 2016–3 to be certain the IRS will issue a ruling about this tax issue. The IRS will not rule in certain areas that involve fact-oriented situations, but will probably issue one here.

11. (LO 1) Letter rulings may be found in:

- Private Letter Rulings (RIA).
- BNA Daily Tax Reports.
- Tax Notes (Tax Analysts).
- Although not referenced in the text, letter rulings are also available in the IRS Letter Rulings Report (CCH).

12. (LO 1) TEAMs are issued by the Office of Chief Counsel to expedite legal guidance to field agents as disputes are developing. TEAMs differ from TAMs as follows:

- A mandatory presubmission conference involves the taxpayer.
- In the event of a tentatively adverse conclusion to the taxpayer or to the field agent, a conference of right will be offered to the taxpayer and to the field agent.
- No further conferences are offered once the conference of right is held.

13. (LO 1) Dwain must consider several factors in deciding whether to take the dispute to the judicial system:

- How expensive will it be?
- How much time will be consumed?
- Does he have the temperament to engage in the battle?
- What is the probability of winning?
- Once a decision is made to litigate the issue, the appropriate judicial forum must be selected.
- Tax Court judges have more expertise in tax matters.

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- The tax deficiency need not be paid to litigate in the Tax Court. However, if Dwain loses, interest must be paid on any unpaid deficiency.
- If a trial by jury is preferred, the U.S. District Court is the appropriate forum.
- The tax deficiency must be paid before litigating in the District Court or the Court of Federal Claims.
- If an appeal to the Federal Circuit is important, Dwain should select the Court of Federal Claims.
- A survey of the decisions involving the issues in dispute is appropriate. If a particular court has taken an unfavorable position, that court should be avoided.

14. (LO 1) The main advantage of the U.S. Court of Federal Claims occurs when a taxpayer's applicable Circuit Court previously rendered an adverse decision. Such a taxpayer may select the U.S. Court of Federal Claims because any appeal will be to the Federal Circuit.

One disadvantage of the U.S. Court of Federal Claims is that the tentative deficiency must be paid before the Court will hear and decide the controversy.

The U.S. Court of Federal Claims is a trial court that usually meets in Washington, D.C. It has jurisdiction for any claim against the United States that is based on the Constitution, any Act of Congress, or any Regulation of an executive department.

15. (LO 1, 5) Hoffman, Young, Raabe, Maloney, & Nellen, CPAs
5191 Natorp Boulevard
Mason, OH 45040

July 8, 2016

Mr. Eddy Falls
200 Mesa Drive
Tucson, AZ 85714

Dear Mr. Falls:

You have three alternatives should you decide to pursue your $229,030 deficiency in the court system. One alternative is the U.S. Tax Court, the most popular forum. Some people believe that the Tax Court judges have more expertise in tax matters. The main advantage is that the U.S. Tax Court is the only trial court where the tax need not be paid prior to litigating the controversy. However, interest will be due on an unpaid deficiency. The interest rate varies from one quarter to the next as announced by the IRS.

One disadvantage of the U.S. Tax Court is the delay that might result before a case is decided. The length of delay depends on the Court calendar, which includes a schedule of locations where cases will be tried. Another disadvantage is being unable to have the case heard before a jury.

The major advantage of another alternative, the U.S. District Court, is the availability of a trial by jury. One disadvantage of a U.S. District Court is that the tentative tax deficiency must be paid before the Court will hear and decide the controversy.

The Court of Federal Claims, the third alternative, is a trial court that usually meets in Washington, D.C. It has jurisdiction for any claim against the United States that is based on the Constitution, any Act of Congress, or any regulation of an executive department. The main advantage of the U.S. Court of Federal Claims occurs when a taxpayer's applicable Circuit Court previously rendered an adverse

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decision. Such a taxpayer may select the Court of Federal Claims because any appeal will be to the Federal Circuit instead. One disadvantage of the Court of Federal Claims is that the tentative deficiency must be paid before the Court will hear and decide the controversy.

I hope this information is helpful, and should you need more help, please contact me.

Sincerely,

Agnes Reynolds, CPA
Tax Partner

16. (LO 1) The U.S. Tax Court hears only tax cases and is the most popular forum for tax cases (generally viewed as an advantage). Some people suggest that the Tax Court has more expertise in tax matters. A taxpayer does not have to pay the tax deficiency assessed by the IRS before trial, but a taxpayer may deposit a cash bond to stop the running of interest (also viewed as an advantage). Appeals from a Tax Court are to the appropriate U.S. Court of Appeals. A disadvantage is that the taxpayer may not obtain a jury trial in the U.S. Tax Court.

17. (LO 1) See Exhibit 2.4, Exhibit 2.5, and Concept Summary 2.1.

    a. There is no appeal by either the taxpayer or the IRS from a decision of the Small Cases Division of the U.S. Tax Court.

    b. The first appeal would be to the Sixth Circuit Court of Appeals. Further appeal would be to the U.S. Supreme Court.

    c. Same as b. above.

    d. The appeal would be to the Federal Circuit Court of Appeals and then to the U.S. Supreme Court.

18. (LO 1) The term *petitioner* is a synonym for plaintiff, which refers to the party requesting action in a court.

19. (LO 1) Both the Code and the Supreme Court indicate that the Federal appellate courts are bound by findings of facts unless they are clearly erroneous. Thus, the *role* of appellate courts is limited to a review of the record of trial compiled by the trial courts. Therefore, the appellate process usually involves a determination of whether the trial court applied the proper law in arriving at its decision. Rarely will an appellate court disturb a lower court's fact-finding determination.

20. (LO 1) See Concept Summary 2.1.

		U.S. Tax Court	U.S. District Court	U.S. Court of Federal Claims
a.	Number of regular judges	19	Varies; one judge hears a case	16
b.	Jury trial	No	Yes	No
c.	Prepayment of deficiency required before trial	No	Yes	Yes

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21. (LO 1) See Exhibit 2.5.

a. Tenth

b. Eighth

c. Ninth

d. Fifth

e. Seventh

22. (LO 1) See Exhibit 2.4.

a. The Tax Court must follow its own cases, the pertinent U.S. Circuit Court of Appeals, and the Supreme Court.

b. The Court of Federal Claims must follow its own decisions, the Federal Circuit Court of Appeals, and the Supreme Court.

c. The District Court must follow its own decisions, the pertinent U.S. Circuit Court of Appeals, and the Supreme Court.

23. (LO 1) The appropriate Circuit Court of Appeals for an appeal depends on where the litigation originated. For example, an appeal from Texas would go to the Fifth Circuit Court of Appeals and an appeal from Colorado would go to the Tenth Circuit Court of Appeals. See Exhibit 2.5.

24. (LO 1, 4)

a. If the taxpayer chooses a U.S. District Court as the trial court for litigation, the U.S. District Court of Wyoming will be the forum to hear the case. Unless the prior decision has been reversed on appeal, one would expect the same court to follow its earlier holding.

b. If the taxpayer chooses the U.S. Court of Federal Claims as the trial court for litigation, the decision that was rendered previously by this Court should have a direct bearing on the outcome. If the taxpayer selects a different trial court (i.e., the appropriate U.S. District Court or the U.S. Tax Court), the decision that was rendered by the U.S. Court of Federal Claims will be persuasive but not controlling. It is, of course, assumed that the result that was reached by the U.S. Court of Federal Claims was not reversed on appeal.

c. The decision of a U.S. Circuit Court of Appeals will carry more weight than will one that was rendered by a trial court. Because the taxpayer lives in California, however, any appeal from a U.S. District Court or the U.S. Tax Court will go to the Ninth Circuit Court of Appeals (see Exhibit 2.4). Although the Ninth Circuit Court of Appeals might be influenced by what the Second Circuit Court of Appeals has decided, it is not compelled to follow such holding. See Exhibit 2.5.

d. Because the U.S. Supreme Court is the highest appellate court, one can place complete reliance upon its decisions. Nevertheless, one should investigate any decision to see whether the Code has been modified with respect to the result that was reached. There also exists the rare possibility that the Court may have changed its position in a later decision. See Exhibit 2.4.

e. When the IRS acquiesces to a decision of the U.S. Tax Court, it agrees with the result that was reached. As long as such acquiescence remains in effect, taxpayers can be assured that this represents the position of the IRS on the issue that was involved. Keep in mind, however, that the IRS can change its mind and can, at any time, withdraw the acquiescence and substitute a nonacquiescence.

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f. The issuance of a nonacquiescence usually reflects that the IRS does not agree with the result that was reached by the U.S. Tax Court. Consequently, taxpayers are placed on notice that the IRS will continue to challenge the issue that was involved.

25. (LO 2) The number 66 is the volume number for the U.S. Tax Court, 39 refers to the page number of the 562nd volume of the *Federal Second Series*, and *nonacq.* means that the IRS disagreed with the decision. The Tax Court (T.C.) cite is to the trial court.

26. (LO 2) There is no automatic right of appeal to the U.S. Supreme Court. Appeal is by Writ of Certiorari. If the Court agrees to hear the dispute, it will grant the Writ (*Cert. granted*). Most often, the highest court will deny jurisdiction (*Cert. denied*).

27. (LO 2)

a. Ninth Circuit Court of Appeals.

b. U.S. Tax Court.

c. U.S. Supreme Court.

d. Bureau of Tax Appeal (old name of U.S. Tax Court).

e. Tax Court (memorandum decision).

f. Court of Claims.

g. Not a court decision.

h. District Court in New York.

i. Not a court decision.

28. (LO 2) See Concept Summary 2.2.

a. This citation is to a regular decision of the U.S. Tax Court that was issued in 1950. The decision can be found in Volume 14, page 74, of the *Tax Court of the United States Report*, published by the U.S. Government Printing Office.

b. This citation is for a decision of the U.S. Fifth Circuit Court of Appeals that was rendered in 1979. The decision can be found in Volume 592, page 1251, of the *Federal Reporter*, Second Series (F. 2d), published by West Publishing Company.

c. This citation is for a decision of the U.S. Sixth Circuit Court of Appeals that was rendered in 1995. The decision can be found in Volume 1 for 1995, paragraph 50,104 of *U.S. Tax Cases*, published by Commerce Clearing House.

d. This citation is for a decision of the U.S. Sixth Circuit Court of Appeals that was rendered in 1995. The decision can be found in Volume 75, page 110, of the *Second Series of American Federal Tax Reports*, published by RIA.

e. This citation is for a decision of the U.S. District Court of Texas that was rendered in 1963. The decision can be found in Volume 223, page 663, of the *Federal Supplement Series*, published by West Publishing Company.

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29. (LO 2)
    a. None.

    b. USTC.

    c. USTC.

    d. USTC.

    e. TCM.

30. (LO 2) Decisions of the U.S. Court of Federal Claims (formerly named the Claims Court) are published in the USTCs; AFTRs; and the West Publishing Co. reporter called the *Federal Reporter, Second Series* (F.2d) (before October 1982) and *Claims Court Reporter* (beginning October 1982 through October 30, 1992). The name of the U.S. Court of Federal Claims was changed from the Claims Court effective October 30, 1992. Currently, this court's decisions are published in the *Federal Claims Reporter*. See Concept Summary 2.2.

31. (LO 1, 2)
    a. Yes. Exhibit 2.3

    b. No. Not published there. Concept Summary 2.2

    c. No. Published by private publishers. Exhibit 2.3

    d. Yes. Exhibit 2.3

    e. Yes. Exhibit 2.3

    f. No. Concept Summary 2.2

    g. Yes. Exhibit 2.3

    h. No. Concept Summary 2.2

32. (LO 3) After understanding the relevant facts:

- Yvonne may begin with the index volumes of the available tax services: RIA, CCH, or BNA Portfolios.

- A key word search on an online service could be helpful—Westlaw (or WestlawNext), LexisNexis, CCH *IntelliConnect*, and Thomson Reuters *Checkpoint*.

- Yvonne may browse through IRS publications (available on the IRS website).

- Yvonne could consult CCH's *Federal Tax Articles* to locate current appropriate articles written about child support payments. Thomson Reuters publishes the *Index to Federal Tax Articles* that is organized using RIA's paragraph index system.

- Yvonne may consult The Accounting & Tax Index, which is available in three quarterly issues and a cumulative year-end volume covering all four quarters.

- Up-to-date information may be found on the Web. Various legal, accounting, and financial gateways can be found by clicking on highlighted words or phrases.

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33. (LO 4) The current Code can be found in various places. Several of the major tax services publish paperback editions of the Code (and Regulations). These editions are usually revised twice each year. An annotated and abridged version of the Code and Regulations is published annually by Cengage (by James E. Smith and Mark Altieri). Further, the text of the Code may be found in the major tax services and as Title 26 of the U.S. Code. The Code also may be found on the Web.

34. (LO 2, 4) The best means of locating tax articles pertinent to your problem is through Commerce Clearing House's *Federal Tax Articles*. This multivolume service includes a subject index, a Code section number index, and an author's index. Another is the *Index to Federal Tax Articles* (published by Thomson Reuters). Both of these indexes are updated periodically, but are available only in print form.

    Court decisions, revenue rulings and procedures, and other relevant authority may be reviewed for reliability by using a *citator* within the commercial tax service. A citator provides the history of a case, including the authority relied on (e.g., other judicial decisions) in reaching the result. Reviewing the references listed in the citator discloses whether the decision was appealed and, if so, with what result (e.g., affirmed, reversed, or remanded). It also reveals other cases with the same or similar issues and how they were decided. Thus, a citator reflects on the validity of a case and may lead to other relevant authority. If one intends to rely on a judicial decision to any significant degree, "running" the case through a citator is imperative.

35. (LO 6) The primary purpose of tax planning is to reduce a taxpayer's overall tax liability. This process can entail an avoidance, a reduction, or a postponement of the tax until the future.

    This process does not mean that the course of action selected must produce the lowest possible tax under the circumstances. Legitimate business goals also must be considered.

    There is nothing illegal or immoral about tax avoidance. A citizen has every legal right to arrange his or her affairs to keep the attendant taxes as low as possible. One is required to pay no more taxes than the law demands. There is no difference between a tax adviser's reduction of a tax expense and a cost accountant's reduction of a cost of operating a business.

36. (LO 7) Simulations on the CPA exam are small case studies designed to test a candidate's tax knowledge and skills using real-life work-related situations. Simulations include a four-function, pop-up calculator, a blank spreadsheet with some elementary functionality, and authoritative excerpts that are necessary to complete the tax case study simulations (e.g., Internal Revenue Code and Federal tax forms). The AICPA plans to make a number of changes to the CPA exam, including increasing the number of simulations, in 2017.

PROBLEMS

37. (LO 1)
    b. p. 2-5

38. (LO 1)
    b. Exhibit 2.3

39. (LO 1)
    d. Exhibit 2.3

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40. (LO 1, 4)
   a. Code section.
   b. Legislative Regulation.
   c. Recent Temporary Regulation.
   d. Interpretive Regulation.
   e. Revenue Ruling.
   f. Letter Ruling.
   g. Proposed Regulation.

41. (LO 4)
   a. P.
   b. P.
   c. P.
   d. S.
   e. P.
   f. S.
   g. P. Valid for three years.
   h. P.
   i. N.
   j P.

42. (LO 1, 2)
   a. CCH.
   b. RIA.
   c. U.S.
   d. CCH.
   e. U.S.
   f. RIA.
   g. W.
   h. W.
   i. W.
   j. W.
   k. U.S.
   l. O.

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43. (LO 6)
    a. E.
    b. E.
    c. A.
    d. A.
    e. A.

RESEARCH PROBLEMS

1. a. *Higgens v. Comm*., 312 U.S. 212 (1941).
   b. *Talen v. U.S.*, 355 F.Supp.2d 22 (D.Ct. D.C., D.D.C., 2004).
   c. Rev.Rul. 2008–18, 2008–13 I.R.B. 674.
   d. *Pahl v. Comm*., 150 F.3d 1124 (CA–9, 1998).
   e. *Veterinary Surgical Consultants PC*, 117 T.C. 141 (2001).
   f. *Yeagle Drywall Co*., T.C. Memo. 2001–284.

2. IRC § 7463(b) states that a decision entered into by any small case decision "shall not be reviewed in any other court and shall not be treated as precedent for any other case."

   In the reviewed opinion *Larry Mitchell* 131 T.C. 215 (2008), the court held that an ex-wife's share of military retirement payments is subject to tax. This same issue had been litigated previously by the taxpayer in *Mitchell*, T.C. Summ. 2004–160.

   In the past, the Tax Court has used collateral estoppel in small tax case decisions to stop (estop) a party from litigating the same issue in a regular Tax Court case. As a result, this reviewed decision seems to contradict their stance. Judge Holmes stated that this Tax Court decision means "that they are without effect on future litigation at all."

3. For the Oprah car giveaway, the 234 audience recipients who received keys to a car were taxed on the value of the car, which was in the $30,000 range. Because they were merely present in the audience, the fair market value was included in gross income under § 61.

   As for the World Furniture Mall promotion, the discount or rebate could be tax-free because a rebate of all or a portion of the purchase price of property generally does not result in gross income. The customer would have a zero basis in the furniture. Rev.Rul. 76–96, 1976–1 C.B. 23 and Rev.Rul. 88–95, 1988–2 C.B. 28. See "Furniture for Nothing and It's all Tax-Free," *Journal of Taxation*, December 2006, pp. 382 and 383.

4. There does not appear to be a clear-cut answer to this question. Section 104 allows exclusion from gross income for damages paid on account of physical injuries and physical sickness. However, the IRS requires observable bodily harm for an exclusion to be available (Ltr.Rul. 200041022).

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So is false imprisonment physical? In CCA 200809001, the IRS allowed an exclusion for a settlement with an institution for sexual abuse. However, the Tax Court in *Daniel and Brenda Stadnyk*, T.C. Memo. 2008–289 would not allow an exclusion for $49,000 received for about one day in a jail.

Brenda Stadnyk was dissatisfied with an automobile purchase, so she placed a stop payment order on the check she tendered to the dealership. Bank One listed the reason for not paying the dealership as a "NSF check." The dealership then filed a criminal complaint against her for passing a worthless check. She spent about one day in a holding area in a county jail.

In "Why False Imprisonment Recoveries Should Not Be Taxable," *Tax Notes*, June 8, 2009, pp. 1217–1220, Robert Wood provides a lengthy discussion of this problem.

Research Problems 5 and 6

The Internet Activity research problems require that students utilize online resources to research and answer the questions. As a result, solutions may vary among students and courses. You should determine the skill and experience levels of the students before assigning these problems, coaching where necessary. Encourage students to explore all parts of the Web in this research process, including tax research databases, as well as the websites of the IRS, newspapers, magazines, businesses, tax professionals, other government agencies, and political outlets. Students should also work with resources such as blogs, Twitter feeds, and other interest-oriented technologies to research their answers.

5. (1) Go to the website, click on the Internal Revenue Code link, click on Subtitle A, and scroll down to Sec. 61. This section defines gross income broadly. In addition to the 15 items specifically listed as income, Sec. 61 directs the reader to other IRC sections and indicates that the list of income items is not all-inclusive. In general, the IRC takes a broad view of income; everything is income unless an IRC section specifies that the amount is not income.

   (2) To find the case, go to the website and click on the US Tax Court link on the left side of the page. Enter the name Mark Spitz in the search bar.

      a. The tax years are 2001 and 2002, as indicated in the first sentence of the case, not 2006, the year in the citation, which is the year the case was decided.
      b. As noted above, 2006.
      c. The court decided in favor of the IRS.
      d. At the end of the decision, the penalty in Sec. 6662 is discussed. This section imposes a 20% accuracy-related penalty on any portion of a tax liability underpayment (the situation in which Mr. Spitz found himself) attributable to a substantial understatement of income tax. Mr. Spitz was found not liable for the penalty because the court indicated that he was unsophisticated in tax law and had relied on a competent adviser to prepare his return.

6. a. On the "Opinions Search" tab, review the "Opinion Type" choices.
   b./c. On the "Opinions Search" tab, select the appropriate opinion type and enter a common last name in the "Case Name Keyword" bar.
   d. Click on the Rules tab on the upper left side of the page.

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SOLUTION TO ETHICS & EQUITY FEATURE

Reporting Tax Fraud (p. 2-7). Most individuals probably believe that it is ethical to report tax fraud. A 2014 IRS Oversight Board survey indicated that 86 percent of Americans believed that it was "not acceptable at all to cheat on taxes." On the other hand, that same survey indicated that 11 percent of taxpayers said that some cheating on their taxes was acceptable.

A number of organizations (including the IRS) provide estimates of the "tax gap," with the most recent estimates indicating that between $300 and $400 billion of unpaid taxes exist each year. These unpaid taxes increase the taxes of honest taxpayers. In fiscal year 2014, the IRS collected $57.2 billion in enforcement revenue.

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NOTES

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1. Slaton served 10 days on jury duty in 2016, for which Slaton was paid $25 per day by the county. Slaton's employer requires employees to remit to it all pay received by the county during jury duty, because Slaton's employer pays employees their normal compensation for the duration of jury duty. Slaton's W–2 income for 2016 is $40,000. What should Slaton's adjusted gross income be for 2016?
   a) $40,250
   b) $40,000
   c) $39,750
   d) $40,125

   a) Incorrect. Slaton will include in gross income both the $40,000 of W-2 income and the $250 earned for jury duty. Since Slaton's employer requires Slaton to remit 100% of the jury duty fees to the employer, the $250 would be an adjustment for adjusted gross income (AGI). As a result, AGI would be $40,000 + $250 - $250 or $40,000.
   b) **Correct!** Slaton will include in gross income both the $40,000 of W-2 income and the $250 earned for jury duty. Since Slaton's employer requires Slaton to remit 100% of the jury duty fees to the employer, the $250 would be an adjustment for adjusted gross income (AGI). As a result, AGI would be $40,000 + $250 - $250 or $40,000.
   c) Incorrect. Slaton will include in gross income both the $40,000 of W-2 income and the $250 earned for jury duty. Since Slaton's employer requires Slaton to remit 100% of the jury duty fees to the employer, the $250 would be an adjustment for adjusted gross income (AGI). As a result, AGI would be $40,000 + $250 - $250 or $40,000.
   d) Incorrect. Slaton will include in gross income both the $40,000 of W-2 income and the $250 earned for jury duty. Since Slaton's employer requires Slaton to remit 100% of the jury duty fees to the employer, the $250 would be an adjustment for adjusted gross income (AGI). As a result, AGI would be $40,000 + $250 - $250 or $40,000.

2. For "qualifying widow(er)" filing status, which of the following requirements must be met?

   I. The surviving spouse does not remarry before the end of the current year
   II. The surviving spouse was eligible to file a joint tax return in the year of the spouse's death
   III. The surviving spouse maintains the cost of the principal residence for six months.

   a) I, II, and III
   b) I and II, but not III
   c) I and III, but not II
   d) I only

a) Incorrect. A taxpayer may file a tax return as a qualifying widow or widower for 2 tax years after the year in which a spouse dies provided the couple qualified to file a joint return for the year of death; that the taxpayer provided over 50% of the cost of maintaining the principal residence of a dependent child or stepchild; and that the taxpayer has not remarried as of the end of the current year. Maintaining the cost of the taxpayer's principal residence for six months is not sufficient.
b) **Correct!** A taxpayer may file a tax return as a qualifying widow or widower for 2 tax years after the year in which a spouse dies provided the couple qualified to file a joint return for the year of death; that the taxpayer provided over 50% of the cost of maintaining the principal residence of

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a dependent child or stepchild; and that the taxpayer has not remarried as of the end of the current year. Maintaining the cost of the taxpayer's principal residence for six months is not sufficient.

c) Incorrect. A taxpayer may file a tax return as a qualifying widow or widower for 2 tax years after the year in which a spouse dies provided the couple qualified to file a joint return for the year of death; that the taxpayer provided over 50% of the cost of maintaining the principal residence of a dependent child or stepchild; and that the taxpayer has not remarried as of the end of the current year. Maintaining the cost of the taxpayer's principal residence for six months is not sufficient.

d) Incorrect. A taxpayer may file a tax return as a qualifying widow or widower for 2 tax years after the year in which a spouse dies provided the couple qualified to file a joint return for the year of death; that the taxpayer provided over 50% of the cost of maintaining the principal residence of a dependent child or stepchild; and that the taxpayer has not remarried as of the end of the current year. Maintaining the cost of the taxpayer's principal residence for six months is not sufficient.

3. Which of the below prevents a husband and wife from filing a joint tax return?

I. The spouses have different accounting methods
II. The spouses have different tax years, provided that both spouses are alive at the end of the year
III. One spouse was a nonresident alien for three months during the year and no proper election was made

a) I and II only
b) II and III only
c) I and III only
d) II only

a) Incorrect. A married couple may file a return as married filing jointly only if they use the same accounting period, although they may use different accounting methods. While a couple generally cannot file a joint return if either is a nonresident alien at any time during the tax year, if a nonresident alien is married to a U.S. citizen or resident alien at the end of the year, the spouses may file jointly.

b) Incorrect. A married couple may file a return as married filing jointly only if they use the same accounting period, although they may use different accounting methods. While a couple generally cannot file a joint return if either is a nonresident alien at any time during the tax year, if a nonresident alien is married to a U.S. citizen or resident alien at the end of the year, the spouses may file jointly.

c) Incorrect. A married couple may file a return as married filing jointly only if they use the same accounting period, although they may use different accounting methods. While a couple generally cannot file a joint return if either is a nonresident alien at any time during the tax year, if a nonresident alien is married to a U.S. citizen or resident alien at the end of the year, the spouses may file jointly.

d) **Correct!** A married couple may file a return as married filing jointly only if they use the same accounting period, although they may use different accounting methods. While a couple generally cannot file a joint return if either is a nonresident alien at any time during the tax

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year, if a nonresident alien is married to a U.S. citizen or resident alien at the end of the year, the spouses may file jointly.

4. Parker and his wife Marie would have been filing a joint tax return for 2014, how- ever Marie died in October 2014. Parker has not remarried and continues to maintain a home for himself and his two children during 2014, 2015, 2016, and 2017. Parker's filing statuses for 2014, 2015, 2016, and 2017 are as follows:

	2014	2015	2016	2017
a.	Qualifying widower	Married filing joint return	Qualifying widower	Head of household
b.	Married filing joint return	Married filing joint return	Head of household	Qualifying widower
c.	Married filing joint return	Qualifying widower	Qualifying widower	Head of household
d.	Qualifying widower	Qualifying widower	Head of household	Qualifying widower

a) Incorrect. A couple may file a joint return if they are married as of the end of the tax year or, when one spouse has died during the tax year, if they were married as of the date of death. As a result, Parker would qualify to file a joint return for 2014. A taxpayer may file a tax return as a qualifying widow or widower for 2 tax years after the year in which a spouse dies provided the couple qualified to file a joint return for the year of death; that the taxpayer provided over 50% of the cost of maintaining the principal residence of a dependent child or stepchild; and that the taxpayer has not remarried as of the end of the current year. As a result, Parker will file as a qualifying widower for 2015 and 2016. In 2017, Parker may no longer file as a qualified widower but may file as a head of household, which is an unmarried taxpayer that maintains a home that is the principal residence of a qualifying relative, such as a child.

b) Incorrect. A couple may file a joint return if they are married as of the end of the tax year or, when one spouse has died during the tax year, if they were married as of the date of death. As a result, Parker would qualify to file a joint return for 2014. A taxpayer may file a tax return as a qualifying widow or widower for 2 tax years after the year in which a spouse dies provided the couple qualified to file a joint return for the year of death; that the taxpayer provided over 50% of the cost of maintaining the principal residence of a dependent child or stepchild; and that the taxpayer has not remarried as of the end of the current year. As a result, Parker will file as a qualifying widower for 2015 and 2016. In 2017, Parker may no longer file as a qualified widower but may file as a head of household, which is an unmarried

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taxpayer that maintains a home that is the principal residence of a qualifying relative, such as a child.

c) **Correct!** A couple may file a joint return if they are married as of the end of the tax year or, when one spouse has died during the tax year, if they were married as of the date of death As a result, Parker would qualify to file a joint return for 2014. A taxpayer may file a tax return as a qualifying widow or widower for 2 tax years after the year in which a spouse dies provided the couple qualified to file a joint return for the year of death; that the taxpayer provided over 50% of the cost of maintaining the principal residence of a dependent child or stepchild; and that the taxpayer has not remarried as of the end of the current year. As a result, Parker will file as a qualifying widower for 2015 and 2016. In 2017, Parker may no longer file as a qualified widower but may file as a head of household, which is an unmarried taxpayer that maintains a home that is the principal residence of a qualifying relative, such as a child.

d) Incorrect. A couple may file a joint return if they are married as of the end of the tax year or, when one spouse has died during the tax year, if they were married as of the date of death. As a result, Parker would qualify to file a joint return for 2014. A taxpayer may file a tax return as a qualifying widow or widower for 2 tax years after the year in which a spouse dies provided the couple qualified to file a joint return for the year of death; that the taxpayer provided over 50% of the cost of maintaining the principal residence of a dependent child or stepchild; and that the taxpayer has not remarried as of the end of the current year. As a result, Parker will file as a qualifying widower for 2015 and 2016. In 2017, Parker may no longer file as a qualified widower but may file as a head of household, which is an unmarried taxpayer that maintains a home that is the principal residence of a qualifying relative, such as a child.

5. Which of the following items are included in determining the total support of a dependent?

I. Medical expenditures paid on behalf of the dependent
II. Life insurance premiums paid on behalf of the dependent
III. Fair rental value of dependent's lodging

a) All of the above
b) I and II only
c) I and III only
d) I only

a) Incorrect. To determine if a taxpayer provided over 50% of a qualifying relative's support, or if more than 50% of the support of a qualifying child was provided by that child, Payments for food, lodging, clothing, education, medical and dental care, recreation, transportation, and other necessities are included. Income, social security, and Medicare taxes paid from the individual's own income; life insurance premiums; and funeral expenses are not included.

b) Incorrect. To determine if a taxpayer provided over 50% of a qualifying relative's support, or if more than 50% of the support of a qualifying child was provided by that child, Payments for food, lodging, clothing, education, medical and dental care, recreation, transportation, and other necessities are included. Income, social security, and Medicare taxes paid from

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the individual's own income; life insurance premiums; and funeral expenses are not included.

c) **Correct!** To determine if a taxpayer provided over 50% of a qualifying relative's support, or if more than 50% of the support of a qualifying child was provided by that child, Payments for food, lodging, clothing, education, medical and dental care, recreation, transportation, and other necessities are included. Income, social security, and Medicare taxes paid from the individual's own income; life insurance premiums; and funeral expenses are not included.

d) Incorrect. To determine if a taxpayer provided over 50% of a qualifying relative's support, or if more than 50% of the support of a qualifying child was provided by that child, Payments for food, lodging, clothing, education, medical and dental care, recreation, transportation, and other necessities are included. Income, social security, and Medicare taxes paid from the individual's own income; life insurance premiums; and funeral expenses are not included.

6. Kyle and Elena Smith contributed to the support of their two children, Alexandra and Matthew, and Elena's divorced father, Nick. For 2016, Alexandra, a 22-year-old full-time college student, earned $1,700 from a part-time job. Matthew, a 27-year-old full-time graduate student, earned $23,000 from his job as a teaching assistant. Nick received $12,000 in capital gains income and $7,000 in nontaxable Social Security benefits. Alexandra, Matthew, and Nick are U.S. citizens and were over one-half supported by Kyle and Elena. How many exemptions can Kyle and Elena claim on their 2016 joint income tax return?

a) 2
b) 3
c) 4
d) 5

a) Incorrect. Kyle and Elena will be able to claim 3 exemptions, including 2 for themselves, on their joint return. Alexandra is a qualifying child since she is a student under the age of 24, resulting in the third exemption. Matthew, being older than 24, is not a qualifying child. Since Nick has gross income, which includes the $12,000 in capital gains but excludes the nontaxable social security benefits, in excess of the exemption amount, Nick is not a qualifying relative and does not provide an additional exemption.

b) **Correct!** Kyle and Elena will be able to claim 3 exemptions, including 2 for themselves, on their joint return. Alexandra is a qualifying child since she is a student under the age of 24, resulting in the third exemption. Matthew, being older than 24, is not a qualifying child. Since Nick has gross income, which includes the $12,000 in capital gains but excludes the nontaxable social security benefits, in excess of the exemption amount, Nick is not a qualifying relative and does not provide an additional exemption.

c) Incorrect. Kyle and Elena will be able to claim 3 exemptions, including 2 for themselves, on their joint return. Alexandra is a qualifying child since she is a student under the age of 24, resulting in the third exemption. Matthew, being older than 24, is not a qualifying child. Since Nick has gross income, which includes the $12,000 in capital gains but excludes the nontaxable social security benefits, in excess of the exemption amount, Nick is not a qualifying relative and does not provide an additional exemption.

d) Incorrect. Kyle and Elena will be able to claim 3 exemptions, including 2 for themselves, on their joint return. Alexandra is a qualifying child since she is a student under the age of 24, resulting in the third exemption. Matthew, being older than 24, is not a qualifying child.

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Since Nick has gross income, which includes the $12,000 in capital gains but excludes the nontaxable social security benefits, in excess of the exemption amount, Nick is not a qualifying relative and does not provide an additional exemption.

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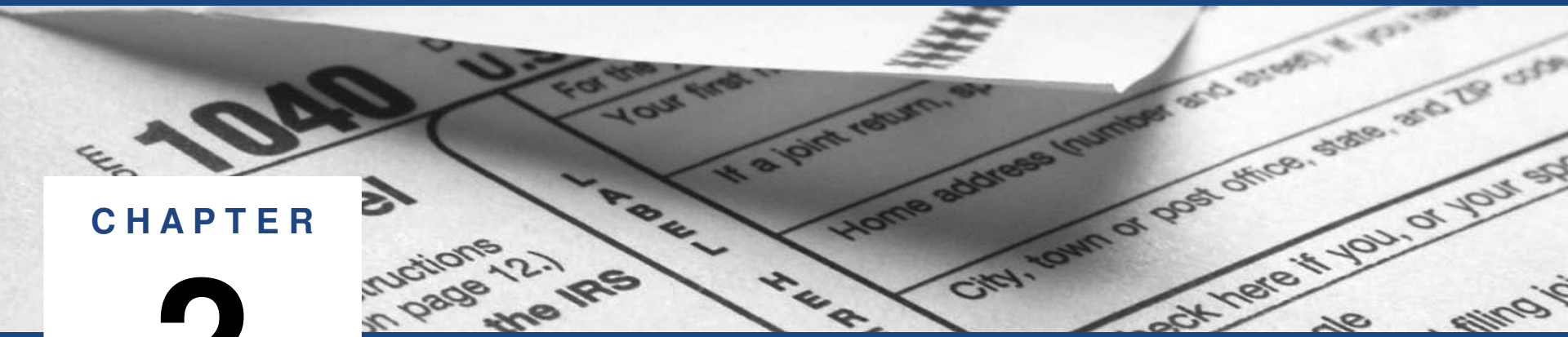

CHAPTER

2

Working With The Tax Law

Individual Income Taxes

SOUTH-WESTERN
FEDERAL TAXATION

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The Big Picture (slide 1 of 2)

- Fred and Megan Samuels review their financial and tax situation with their son, Sam, and daughter-in-law, Dana, who live with them
  - Fred and Megan are in the 28% tax bracket in 2016
  - Both Sam and Dana are age 21
- Sam, a student at a nearby university, owns some publicly traded stock that he inherited
    - A current sale would result in approximately $8,000 of gross income
      - ($19,000 amount realized – $11,000 adjusted basis)

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The Big Picture (slide 2 of 2)

- Fred and Megan provide about 55% of Sam and Dana's support
  - Although neither is now employed, Sam has earned $960 and Dana has earned $900
- The problem:
  - Should the stock be sold?
  - Would the sale prohibit Fred and Megan from claiming Sam and Dana as dependents?
  - Would the stock sale in 2016 result in a tax liability for Sam and Dana?
- Read the chapter and formulate your responses

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Statutory Sources of Tax Law
(slide 1 of 2)

- Internal Revenue Code
  - Codification of the Federal tax law provisions in a logical sequence
  - Have had three codes:
    - 1939, 1954, 1986

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Statutory Sources of Tax Law
(slide 2 of 2)

- Example of Code Citation: § 2(a)(1)(A)
  - § = abbreviation for “Section”
  - 2 = section number
  - (a) = subsection
  - (1) = paragraph designation
  - (A) = subparagraph designation

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Legislative Process For Tax Bills

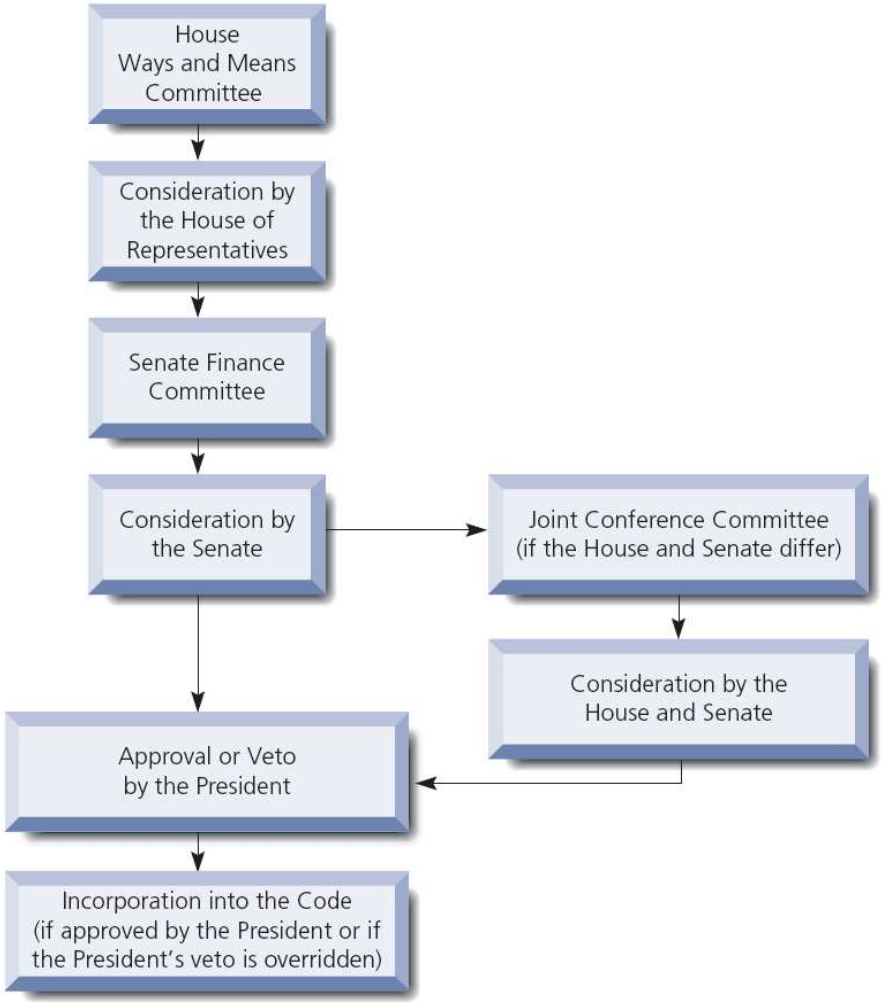

Exhibit 2.1

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Administrative Sources of Tax Law (slide 1 of 2)

- Treasury Department Regulations
- Revenue Rulings
- Revenue Procedures, and
- Various other administrative pronouncements

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Administrative Sources of Tax Law (slide 2 of 2)

Source	Location	Authority
Regulations	*Federal Register*	Force and effect of law.
Temporary Regulations	*Federal Register* *Internal Revenue Bulletin* *Cumulative Bulletin*	May be cited as a precedent.
Proposed Regulations	*Federal Register* *Internal Revenue Bulletin* *Cumulative Bulletin*	Preview of final Regulations.
Revenue Rulings Revenue Procedures Treasury Decisions Actions on Decisions	*Internal Revenue Bulletin* *Cumulative Bulletin*	Do not have the force and effect of law.
General Counsel Memoranda Technical Advice Memoranda	Tax Analysts' *Tax Notes;* Thomson Reuters *Checkpoint**; Commerce Clearing House *IntelliConnect*	May not be cited as a precedent.
Letter Rulings	Thomson Reuters and Commerce Clearing House tax services	Applicable only to taxpayer addressed. No precedential force.

* Thomson Reuters *Checkpoint* includes a wide variety of tax resources. The most significant are materials produced by the Research Institute of America (RIA), including the *Federal Tax Coordinator 2d.*

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Regulations (slide 1 of 4)

- Issued by U.S. Treasury Department
- Provide general interpretations and guidance in applying the Code

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Regulations (slide 2 of 4)

- Issued as:
  - Proposed: preview of final regulations
    - Do not have force and effect of law
  - Temporary: issued when guidance needed quickly
    - Same authoritative value as final regulations
  - Final:
    - Force and effect of law

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Regulations (slide 3 of 4)

- Example of Regulation citation:
  - Reg. § 1.2
    - Refers to Regulations under Code § 2
    - Subparts may be added for further identification
    - The numbering patterns of these subparts often have no correlation with the Code subsections

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Regulations (slide 4 of 4)

- Example of Proposed Regulation citation: Prop. Reg. § 1.2
- Example of Temporary Regulation citation: Temp. Reg. § 1.6081–8T

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Revenue Rulings (slide 1 of 2)

- Officially issued by National Office of IRS
  - Provide specific interpretations and guidance in applying the Code
  - Less legal force than Regulations
  - Issued in IRB and accumulated in the Cumulative Bulletins

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Revenue Rulings (slide 2 of 2)

- Example of Revenue Ruling citation
  - Rev.Rul. 2015–9, 2015–21 I.R.B. 972
    - Explanation: Revenue Ruling Number 9, appearing on page 972 of the 21st weekly issue of the Internal Revenue Bulletin for 2015

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Revenue Procedures (slide 1 of 2)

- Concerned with the internal management practices and procedures of the IRS
  - Issued similar to Revenue Rulings
  - Issued in IRB and accumulated in the Cumulative Bulletins

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Revenue Procedures (slide 2 of 2)

- Example of Revenue Procedure citation
  - Rev. Proc. 92-29, 1992-1 CB 748
    - 29th Rev. Procedure in 1992 found in volume 1 of Cumulative Bulletin on page 748

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Letter Rulings (slide 1 of 2)

- Offer guidance to taxpayer on how a transaction will be taxed before proceeding with it
  - Issued for a fee upon a taxpayer's request
  - Describe how the IRS will treat a proposed transaction
- Apply only to the taxpayer who asks for and obtains the ruling
  - Post-1984 letter rulings may be substantial authority for purposes of the accuracy-related penalty
- Limited to restricted, preannounced areas of taxation

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Letter Rulings (slide 2 of 2)

- Example of Letter Ruling citation
  - Ltr.Rul. 201503010
    - 10th ruling issued in the 3rd week of 2015

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Other Administrative Pronouncements
(slide 1 of 4)

- Treasury Decisions-issued by Treasury Dept. to:
  - Promulgate new or amend existing Regulations
  - Announce position of the Government on selected court decisions
  - Published in the Internal Revenue Bulletin
    - Then transferred to the Cumulative Bulletin

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Other Administrative Pronouncements
(slide 2 of 4)

- Determination Letters
  - Issued by Area Director at taxpayer's request
  - Usually involve completed transactions
  - Not published
    - Made known only to party making the request

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Other Administrative Pronouncements
(slide 3 of 4)

- The IRS also publishes other administrative communications such as
  - Announcements
  - Notices
  - IRs (News Releases)
  - Internal Legal Memoranda (ILMs)
  - Chief Counsel Notices (CC)
  - Prohibited Transaction Exemptions

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Other Administrative Pronouncements
(slide 4 of 4)

- A variety of internal memoranda that constitute the working law of the IRS also are released but not officially published, such as
  - General Counsel Memoranda (GCMs)
  - Technical Advice Memoranda (TAMs)
  - Internal Legal Memoranda (ILMs)
  - Field Service Advice Memoranda (FSAs)
- The IRS indicates that they may not be cited as precedents by taxpayers
  - However, these working documents do explain the IRS's position on various issues.

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Federal Judicial System

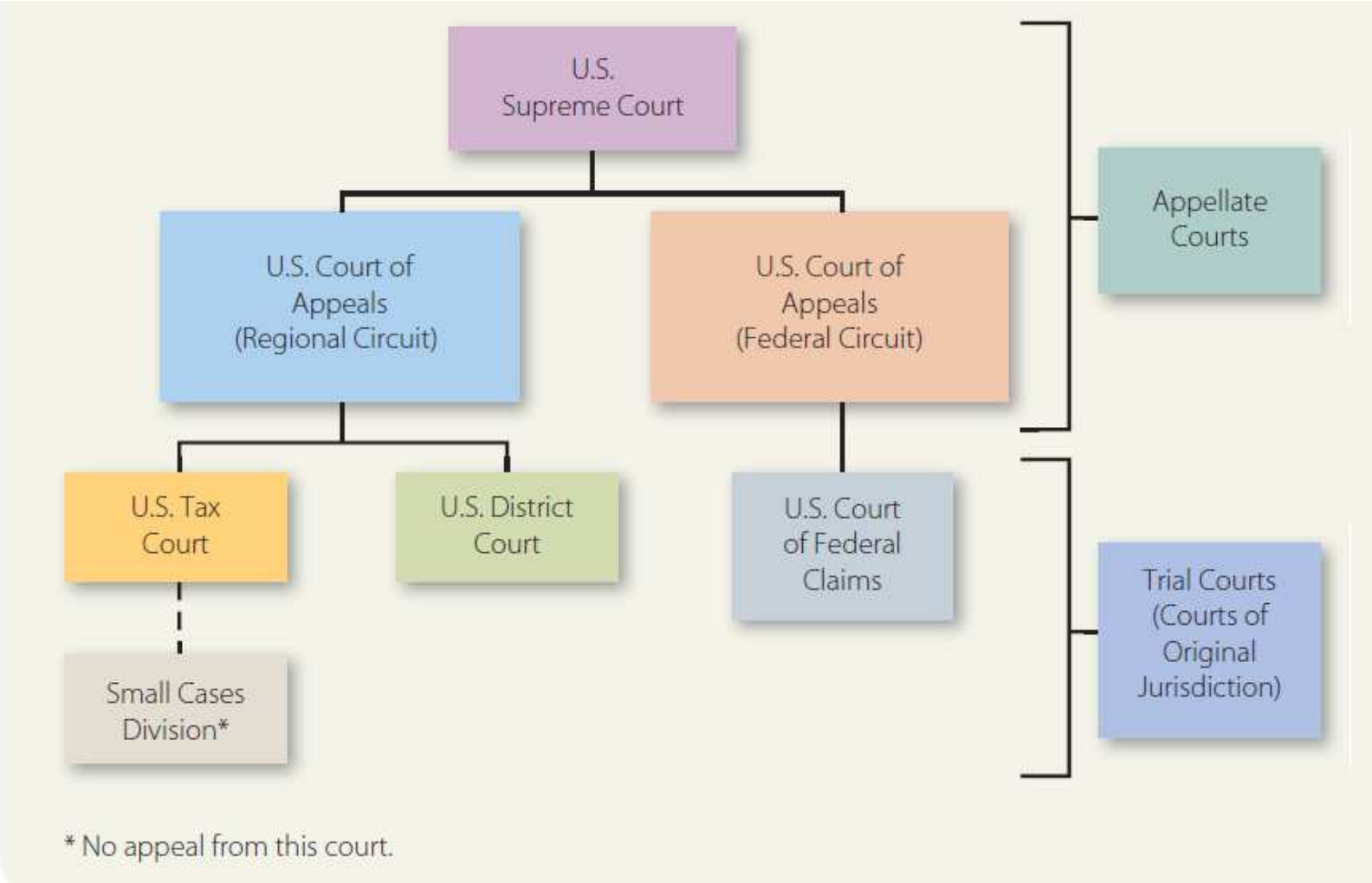

Exhibit 2.4

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Judicial Sources (slide 1 of 2)

- There are four courts of original jurisdiction (trial courts)
  - U.S. Tax Court: Regular
  - U.S. Tax Court: Small Cases Division
  - Federal District Court
  - U.S. Court of Federal Claims

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Judicial Sources (slide 2 of 2)

Concept Summary 2.1

Federal Judicial System: Trial Courts

Issue	U.S. Tax Court	U.S. District Court	U.S. Court of Federal Claims
Number of judges per court	19*	Varies	16
Payment of deficiency before trial	No	Yes	Yes
Jury trial available	No	Yes	No
Types of disputes	Tax cases only	Most criminal and civil issues	Claims against the United States
Jurisdiction	Nationwide	Location of taxpayer	Nationwide
IRS acquiescence policy	Yes	Yes	Yes
Appeal route	U.S. Court of Appeals	U.S. Court of Appeals	U.S. Court of Appeals for the Federal Circuit

*Currently, there are also 4 special trial judges and 13 senior judges.

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Appeals Process

- Appeals from District Court or Tax Court go to the U.S. Court of Appeals for circuit where taxpayer resides
- Appeals from Court of Federal Claims is to Court of Appeals for the Federal Circuit
- Appeal to the Supreme Court is by Writ of Certiorari
  - Only granted for those cases it desires to hear

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Courts' Weights As Precedents

- From high to low:
  - Supreme Court
  - Circuit Court of Appeals
  - Tax Court (Regular), U.S. Court of Federal Claims, & U.S. District Courts
- Decisions of the Small Cases Division of the Tax Court have no precedential value and cannot be appealed

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Tax Court (slide 1 of 3)

- Issues two types of decisions: Regular and Memorandum
  - Regular decisions involve novel issues not previously resolved by the court
- Regular decisions are published by the U.S. government, for example

Temporary Citation	*MoneyGram International, Inc. and Subsidiaries*, 144 T.C. ___, No. 1 (2015). *Explanation:* Page number left blank because not yet known.
Permanent Citation	*MoneyGram International, Inc. and Subsidiaries*, 144 T.C. 1 (2015). *Explanation:* Page number now available.

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Tax Court (slide 2 of 3)

- Tax Court Memorandum decisions
  - Memorandum decisions deal with situations necessitating only the application of already established principles of law
  - Memorandum decisions were not published by the U.S. Government until recently

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Tax Court (slide 3 of 3)

- Memorandum decisions were—and continue to be—published by several tax services
  - Consider, for example, three different ways that *Nick R. Hughes* can be cited:
    - *Nick R. Hughes*, T.C.Memo. 2009–94
      - The 94th Memorandum decision issued by the Tax Court in 2009
    - *Nick R. Hughes*, 97 TCM 1488
      - Page 1488 of Vol. 97 of the CCH Tax Court Memorandum Decisions
    - *Nick R. Hughes*, 2009 RIA T.C.Memo. ¶2009,094
      - Paragraph 2009,094 of the RIA T.C. Memorandum Decisions

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Examples Of District Court Decision Citations

- *Turner v. U.S.*, 2004–1 USTC ¶60,478 (D.Ct. Tex., 2004) (CCH citation)

- *Turner v. U.S.*, 93 AFTR 2d 2004–686 (D.Ct. Tex., 2004) (RIA citation)

- *Turner v. U.S.*, 306 F.Supp.2d 668 (D.Ct. Tex., 2004)(West citation)

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Supreme Court Decisions

- Examples of citations
  - U.S. v. The Donruss Co., (USSC, 1969)
    - 69-1 USTC ¶9167 (CCH citation)
    - 23 AFTR2d 69-418 (RIA citation)
    - 89 S. CT 501 (West citation)
    - 393 U.S. 297 (U.S. Government citation)
    - 21 L.Ed.2d 495 (Lawyer's Co-operative Publishing Co. citation)

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Tax Treaties

- The U.S. signs tax treaties with foreign countries to:
  - Avoid double taxation
  - Render mutual assistance in tax enforcement
- Neither a tax law nor a tax treaty takes general precedence
  - When there is a direct conflict, the most recent item will take precedence
  - A taxpayer must disclose on the tax return any position where a treaty overrides a tax law
    - There is a $1,000 penalty per failure to disclose for individuals ($10,000 for corporations)

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Tax Research Tools (slide 1 of 2)

- A crucial part of the research process is the ability to locate appropriate sources of the tax law
  - Both electronic and paper-based research tools are available to aid in this search
- Unless the problem is simple (e.g., the Code Section is known, and there is a Regulation on point), the research process should begin with a tax service

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Tax Research Tools (slide 2 of 2)

- A partial list of the available commercial tax services includes:
  - Standard Federal Tax Reporter, CCH
  - CCH IntelliConnect, CCH Internet service
  - United States Tax Reporter, RIA
  - RIA Checkpoint, RIA
  - ATX/Kleinrock Tax Expert, CCH/Wolters Kluwer
  - Tax Management Portfolios, BNA
  - Mertens Law of Federal Income Taxation, Thomson Reuters
  - Westlaw services (including access to Tax Management Portfolios)
  - TaxCenter, LexisNexis
  - Federal Research Library, Tax Analysts

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Tax Research Process

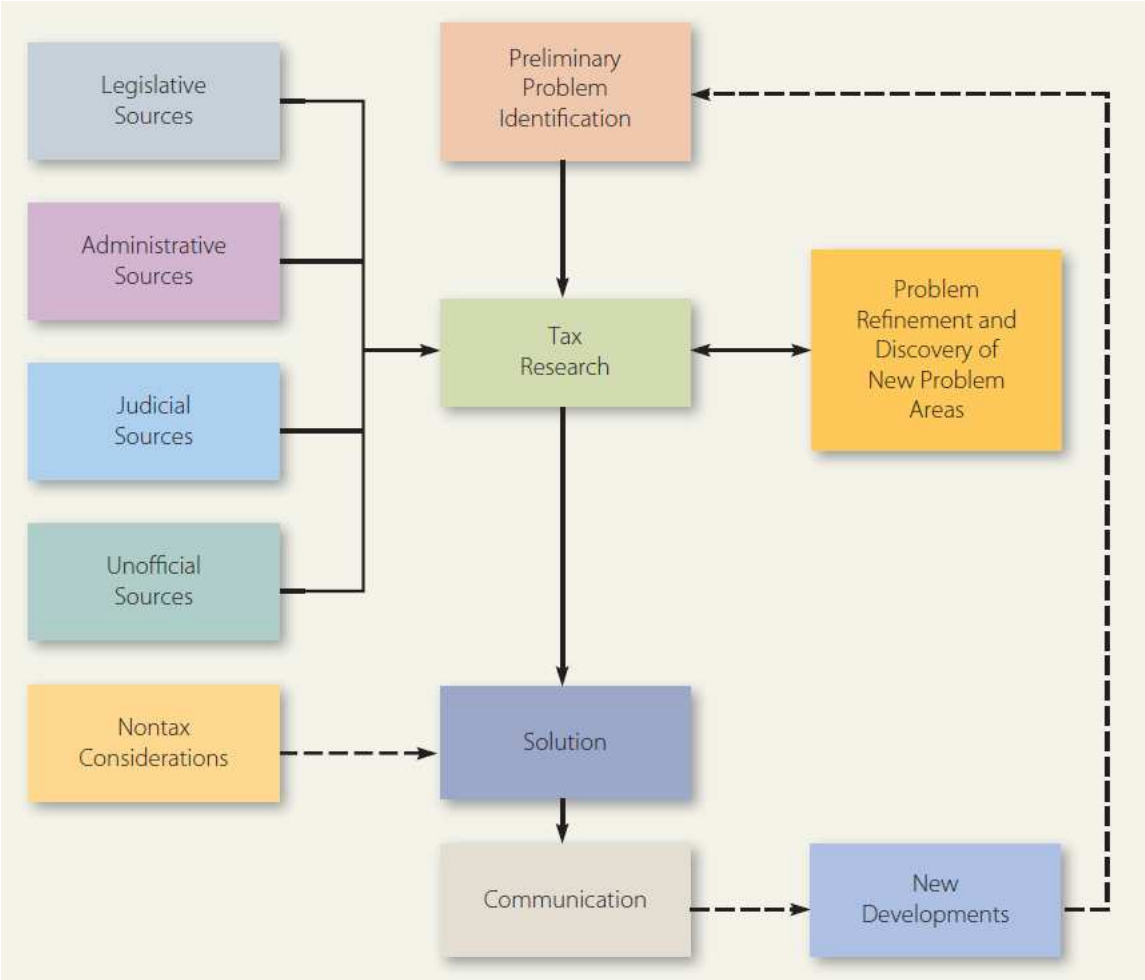

EXHIBIT 2.8

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Tax Research

- Tax research is the method by which an interested party determines the best solution to a tax situation
- Tax research involves:
  - Identifying and refining the problem
  - Locating the appropriate tax law sources
  - Assessing the validity of the tax law sources
  - Arriving at the solution or at alternative solutions with due consideration given to nontax factors

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Assessing The Validity Of Tax Law Sources (slide 1 of 4)

- Regulations
  - IRS agents must give the Code and the Regulations equal weight when dealing with taxpayers and their representatives
  - Proposed Regulations are not binding on IRS or taxpayer
  - Burden of proof is on taxpayer to show Regulation incorrect
  - If the taxpayer loses the challenge, a 20% negligence penalty may be imposed

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Assessing The Validity Of Tax Law Sources (slide 2 of 4)

- Final Regulations tend to be of three types
  - Procedural: housekeeping-type instructions
  - Interpretive: rephrase what is in Committee Reports and the Code
    - Hard to get overturned
  - Legislative: allow the Treasury Department to determine the details of law
    - Congress has delegated its legislative powers and these cannot generally be overturned

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Assessing The Validity Of Tax Law Sources (slide 3 of 4)

- Revenue Rulings
  - Carry less weight than Regulations
  - Not substantial authority in court disputes

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Assessing The Validity Of Tax Law Sources (slide 4 of 4)

- Judicial sources
  - Consider the level of the court and the legal residence of the taxpayer
  - Tax Court Regular decisions carry more weight than Memo decisions
    - Tax Court does not consider Memo decisions to be binding precedents
    - Tax Court reviewed decisions carry even more weight
  - Circuit Court decisions where certiorari has been requested and denied by the U.S. Supreme Court carry more weight than a Circuit Court decision that was not appealed
  - Consider whether the decision has been overturned on appeal

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Tax Law Sources (slide 1 of 2)

- Primary sources of tax law include:
  - The Constitution
  - Legislative history materials
  - Statutes
  - Treaties
  - Treasury Regulations
  - IRS pronouncements, and
  - Judicial decisions
- In general, the IRS considers only primary sources to constitute substantial authority

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Tax Law Sources (slide 2 of 2)

- Secondary Sources include:
  - Legal periodicals
  - Treatises
  - Legal opinions
  - General Counsel Memoranda, and
  - Written determinations
- In general, secondary sources are not authority

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Tax Planning

- Consider social, economic, and business goals as well as tax motives
- Tax avoidance is the legal minimization of tax liabilities and one goal of tax planning
- Tax evasion is the illegal minimization of tax liabilities
  - Suggests the use of subterfuge and fraud as a means to tax minimization
  - Can lead to fines and jail

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Taxation on the CPA Examination

- Taxation is included in the 3-hour Regulation section and covers:
  - Federal tax process, procedures, accounting, and planning
  - Federal taxation of property transactions
  - Federal taxation—individuals
  - Federal taxation—entities
- Knowledge is tested using both multiple-choice questions and case studies called simulations

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If you have any comments or suggestions concerning this PowerPoint Presentation for South-Western Federal Taxation, please contact:

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CHAPTER 2

WORKING WITH THE TAX LAW

LECTURE NOTES

OVERVIEW

Federal tax law is a mixture of statutory provisions, administrative pronouncements, and court decisions. Anyone who has attempted to work with this body of knowledge is familiar with its complexity. Tax research provides the vehicle by which one makes sense out of this complexity.

SUMMARY OF CHANGES IN THE CHAPTER

The following are notable changes in the chapter from the 2016 Edition. For major changes, see the Preface to the Instructor's Edition of the text.

- Updated references and citations throughout the chapter.
- Added a new Ethics & Equity feature on tax fraud.
- Updated materials on administrative tax law sources and commercial tax services.

THE BIG PICTURE

The Big Picture discussion in Chapter 2 introduces the introductory tax student to the idea that answers to tax questions will not always be found in the tax textbook and that research often needs to be undertaken to answer the question.

The discussion in Section 2-3 of the chapter takes the student through the answer to the research questions posed. Depending on the research services available, the instructor might ask the students to formulate keyword searches and then demonstrate what happens when those searches are undertaken in the research service. The instructor could also demonstrate the index feature of the research services to look up topics related to dependents or dependency exemptions. Alternatively, the instructor could ask the students to see if they could verify the correctness of the textbook conclusion or change one of the key facts (e.g., change the relationship between the taxpayers so that the qualifying relative test applies) and to determine how the conclusion would change, if at all.

TAX SOURCES

Statutory Sources of the Tax Law

1. Statutory sources of law include the Constitution (Article I, Sections 7, 8, and 10), tax treaties, and the Internal Revenue Code.

2. Origin of the Internal Revenue Code.

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a. Constitution. The source of the Federal taxing authority is the U.S. Constitution: "The Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States." (Art. I, § 8, Cl. 1)

b. Sixteenth Amendment. The Sixteenth Amendment is the foundation of our Federal income tax: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

3. Internal Revenue Code. The Code generally is supreme in the Federal tax area, unless a U.S. tax treaty is in direct conflict. In this case, TAMRA of 1988 provides that neither a tax law nor a tax treaty takes general precedence. Instead, the most recent item will take precedence.

a. Role of Congress. Unless a *constitutional* issue is involved, Congress can override a U.S. Supreme Court decision by amending the Code.

(1) Code supremacy. This Court supremacy is not the case when the Internal Revenue Code is concerned (i.e., Congress can change the law).

b. Congressional Committee Reports. Congressional Committee Reports may be helpful in interpreting the Code.

(1) Congressional intent. Such reports reflect the intent of Congress in implementing or changing the tax law.

(2) *Cumulative Bulletins*. The Committee Reports usually are conveniently available in special volumes of the *Cumulative Bulletins* as well as online, on the committee's web page (e.g., http://waysandmeans.house.gov/).

c. Public and closed congressional hearings. Congress holds both public and closed hearings on tax proposals.

(1) After public hearings before the House Ways and Means Committee, the public may be excluded in a closed session.

(2) Tax bills may be debated under a closed rule before the full House with approval by the Rules Committee.

(3) Under this closed rule, amendments are not allowed on the House floor unless approved by the House Ways and Means Committee.

(4) The full Senate, however, does not have a closed rule process.

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d. Organization of the Code. The Code is organized into Subtitles, Chapters, and Subchapters. See Figure 2-1 in these Lecture Notes.

e. Interrelation of Code provisions. Tying the various Code provisions together to reach the total result is important.

(1) For example, consider why there are three separate sections dealing with alimony.

(2) Section 71 (in the gross income sequence) makes it taxable to the payee; § 215 (in the deduction sequence) makes it deductible to the payor; while § 62(a)(10) classifies the deduction (as a deduction for AGI) for the payor.

f. Subpart designations. The designation given to the subparts of a Code section will vary.

(1) The usual approach has been to use (a), (b), etc. [e.g., § 162(a)].

(2) On occasion, however, the designation is (1), (2), etc. [e.g., § 212(1)].

g. Code section numbers. Section numbers do not repeat in the same title of the Code. Some Code section numbers contain a capital letter (e.g., a numerical designation such as §§ 453A, 453B).

(1) The reason is that certain numerical sequences in the Code have no space for expansion.

(2) Since there exists a § 453 and a § 454, how else would the two intervening provisions be designated?

h. Recodification. The Internal Revenue Code has been recodified twice.

(1) Internal Revenue Codes of 1939 and 1954. The first was in 1939 and the second was in 1954.

(2) Internal Revenue Code of 1986. Although Congress did not codify and rearrange the law in the Tax Reform Act of 1986, the radical changes did provide some rationale for renaming the entire tax law in the Internal Revenue Code of 1986.

i. General explanation of the act. Upon the completion of major tax legislation, the staff of the Joint Committee on Taxation (in consultation with the staffs of the House Ways and Means and Senate Finance Committees) often will prepare a general explanation of the act.

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(1) Bluebook: no legal effect. Commonly known as the "bluebook" because of the color of its cover, the IRS will not accept this detailed explanation as having legal effect (except for purposes of the accuracy-related penalty in § 6662).

(2) Bluebook: temporary guidance. The "bluebook," however, does provide valuable guidance to tax advisers and taxpayers until Regulations are issued, and some letter rulings and general counsel memoranda of the IRS cite such explanations.

4. The legislative process.

a. Evolution of tax law. Some provisions in the tax law take years to become law (e.g., H.R. 10 or Keogh plans).

(1) This process means that with each new Congress the measure had to be reintroduced until it finally gained the required support.

(2) An example of a provision that currently seems to be going through this process is the provision to tax carried interest at ordinary income rather than capital gains tax rates.

b. Deadwood bills. On occasion, Congress will enact deadwood bills. The purpose of such legislation is to "clean up" provisions that are obsolete and possess no continuing validity.

c. Origin of a tax bill. Tax legislation normally originates in the House Ways and Means Committee of the House of Representatives because the U.S. Constitution mandates that revenue raising bills begin in the House. A tax bill might originate in the Senate when it is attached to other legislative proposals.

(1) The Tax Equity and Fiscal Responsibility Act of 1982 originated in the Senate, and its constitutionality was unsuccessfully challenged in the courts.

(2) The Senate version of the Deficit Reduction Act of 1984 was attached as an amendment to the Federal Boat Safety Act.

d. Naming tax legislation. Some tax provisions are commonly referred to by the number the bill received in the House when first proposed or by the name of the member of Congress sponsoring the legislation. For example, the Self-Employed Individuals Tax Retirement Act of 1962 is popularly known as H.R. 10 (House of Representatives Bill No. 10) or as the Keogh Act (Keogh being one of the members of Congress sponsoring the bill). The Roth IRA is named after the late Senator William Roth, an influential sponsor. Coverdell Education Savings

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Accounts (first called education IRAs) are named after the late Senator Paul Coverdell (R–GA).

e. Beginning in 1997, the president was supposed to be able to cancel provisions from enacted tax legislation under the Line Item Veto Act. President Clinton, on August 11, 1997, did strike two provisions from TRA of 1997 and one nontax provision from the Balanced Budget Act. Congress did not override these cancellations, but the constitutionality of the Line Item Veto Act was challenged in the court system and the Supreme Court held it unconstitutional.

f. Tax legislation is referred from the Senate Finance Committee to the entire Senate. If the House and Senate tax bills disagree, the Joint Conference Committee resolves the differences. (See Exhibits 2.1 and 2.2 in the text.)

5. Arrangement of the Code. The Internal Revenue Code of 1986 is found in Title 26 of the U.S. Code. In working with the Code, it helps to understand the format. The key is usually the section number. For example, in citing Section 2(a), it is unnecessary to include Subtitle A, Chapter 1, Subchapter A, Part I. Mentioning Section 2(a) is sufficient. (See Citing the Code in the text.)

Administrative Sources of the Tax Law (See Exhibit 2.1 in the text.)

6. Treasury Department regulations. The Treasury Department under § 7805(a) has a duty to issue rules and regulations to explain and interpret the Code.

a. Treasury decisions. Final Regulations are issued as Treasury Decisions (TDs) in the *Federal Register*. Regulations carry considerable authority as the official interpretation of tax statutes. They are arranged in the same sequence as the Internal Revenue Code and have the force and effect of law.

b. Types of regulations issued:

(1) Legislative Regulations.

(2) Interpretative Regulations.

(3) Procedural Regulations.

(4) Temporary Regulations may be cited as precedent and are found in the *Federal Register*, *Internal Revenue Bulletin*, and *Cumulative Bulletin*. They are also concurrently issued as Proposed Regulations (in order to become Final Regulations) and automatically expire within three years after the date of issuance.

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ETHICS & EQUITY

Reporting Tax Fraud. Would you turn in someone you knew wasn't paying all their taxes? The IRS certainly tries to encourage tax fraud reporting by offering a portion of the resulting collections to the whistleblower. You can use this Ethics & Equity feature to spark a discussion with your class. What would motivate your students to turn someone in: the satisfaction of getting back at someone they didn't like, the need to adhere to a private moral code, or something else? Would the size of the monetary reward from the IRS affect your students' decisions? And is it ethical of the IRS to pay people to tattle on their tax-dodging literal and metaphorical neighbors, or should justice be its own reward?

c. Validity of a regulation. One way courts assess the validity of a Regulation is by the legislative reenactment doctrine. A Regulation is considered to have received congressional approval if the regulation was finalized many years earlier and during the interim period Congress has not amended the relevant statutory language.

d. Information in *Cumulative Bulletins* and *Internal Revenue Bulletins*. The I.R.B.s for a six-month period are gathered together and published in a bound volume designated as a C.B.

7. Revenue Rulings and Revenue Procedures. The C.B.s and I.R.B.s include a variety of administrative sources, including Revenue Rulings and Revenue Procedures.

a. Revenue Rulings are official pronouncements of the National Office of the IRS and provide guidance to both IRS personnel and taxpayers in handling routine tax matters. They usually deal with more restricted problems than Regulations and do not carry the same legal force and effect as Regulations.

b. Revenue Procedures are issued in the same manner as Revenue Rulings, but they deal with the internal management practices and procedures of the IRS. Revenue Procedures do not carry the same legal force and effect as Regulations.

c. Other materials included in the I.R.B and C.B.:

(1) Announcements of Proposed Regulations as well as the related public hearings.

(2) Treasury decisions.

(3) Executive orders.

(4) Tax conventions (i.e., international treaties).

(5) Legislation (including Committee Reports).

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(6) Certain court decisions.

(7) Announcements of court decisions to which the IRS acquiesces or does not acquiesce.

(8) Punitive action (e.g., disbarment, suspension) taken against persons (e.g., attorneys, CPAs) practicing before the IRS.

8. Letter rulings. Letter rulings and determination letters have in common the fact that they apply only to the person who requested the ruling or letter. Note that neither is published by the IRS, but made available to private publishers.

   a. Letter ruling. A letter ruling is a statement issued by the National Office of the IRS in response to a taxpayer's request, which applies the tax law to a proposed transaction. Revenue rulings can result from a taxpayer request for a letter ruling.

   b. Determination letter. A determination letter is a statement issued by the Area Director in response to a taxpayer, which applies the tax law to a completed transaction.

9. Other administrative pronouncements. These sources are not the same.

   a. Technical Memoranda (TMs) are memoranda from the IRS Commissioner to the Assistant Secretary of the Treasury for Tax Policy. They are drafted by the Legislation and Regulation Division of the Office of Chief Counsel and relate to proposed Treasury Decisions or Regulations.

   b. Technical Advice Memoranda (TAMs) are furnished by the National Office of the IRS upon request of an Area Director or an Appeals Officer of the IRS in response to any technical or procedural question (e.g., a completed transaction).

ADDITIONAL LECTURE RESOURCE

Provider of the Tax Law Source

Internal Revenue Code	Congress/President
Regulations	U.S. Treasury Department
Revenue Ruling	National Office of IRS
Letter Ruling	National Office of IRS
Notices and Announcements	National Office of IRS
Determination Letter	Area Director of IRS
Technical Advice Memorandum	National Office of IRS
Treasury Decision	U.S. Treasury Department
Revenue Procedure	National Office of IRS
General Counsel Memorandum	General Counsel's Office of IRS
Action on Decision	Office of Chief Counsel of IRS
Field Service Advice	Office of Chief Counsel of IRS

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Judicial Sources of the Tax Law

10. Precedential value. American law, following English common law, is frequently "made" by judicial decisions. Under the doctrine of *stare decisis*, each decision has precedential value for future decisions with the same controlling set of facts.

11. The judicial process in general. After a taxpayer has exhausted some or all of the remedies available within the IRS, the dispute can be taken to the Federal courts. A taxpayer chooses the route to pursue a tax conflict from among four alternatives (as illustrated in Exhibit 2.4 and Concept Summary 2.1 in the text).

    a. U.S. Court of Federal Claims (hears tax and other monetary claims against the Federal government). This court formerly was called the U.S. Claims Court. There is only one U.S. Court of Federal Claims. The court meets most often in Washington, D.C. Decisions are appealed to the U.S. Court of Appeals (Federal Circuit).

    b. U.S. Tax Court (hears only tax cases). Taxpayer does not pay the deficiency before trial. Decisions are appealed to the U.S. Court of Appeals (Regional Circuit).

    c. Small Cases Division of the U.S. Tax Court (hears only tax cases). No appeal available. The broken line between the U.S. Tax Court and the Small Cases Division in Exhibit 2.4 in the text indicates that there is no appeal from the Small Cases Division.

        (1) $50,000 or less. This court hears cases involving disputed amounts of $50,000 or less.

        (2) No written record. The proceedings are informal, and there was no written record of such cases before 2002. Some of the more recent cases can now be found on the U.S. Tax Court website or in online research services.

        (3) Informal proceedings.

            (a) No necessity for the taxpayer to be represented by a lawyer or other tax adviser.

            (b) Special trial judges, rather than Tax Court judges, preside over the proceedings.

            (c) Decisions are not precedent for any other court and are not reviewable by any higher court.

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d. U.S. District Courts (hear tax as well as nontax cases). A jury trial is available. Decisions are appealed to the U.S. Court of Appeals (Regional Circuit). See Exhibit 2.4 in the text.

12. Trial courts. (See Concept Summary 2.2 in the text.) The differences among the various trial courts can be summarized as follows:
    - Number of courts.
    - Number of judges.
    - Location.
    - Jurisdiction of the Court of Federal Claims.
    - Jurisdiction of the Tax Court and District Courts.
    - Jury trial.
    - Payment of deficiency.
    - Termination of running of interest.
    - Appeals.
    - Bankruptcy.

13. Appellate courts. The two appellate courts are the Circuit Courts of Appeal (11 geographical circuits, the circuit for the District of Columbia, and the Federal Circuit) and the Supreme Court (see Exhibit 2.4 in the text).

    a. All courts must follow the decisions of the U.S. Supreme Court.

    b. A particular Court of Appeals need not follow the decisions of another Court of Appeals.

    c. District Courts, the Tax Court, and the Court of Federal Claims must abide by the precedents set by the Court of Appeals of the relevant jurisdiction.

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ADDITIONAL LECTURE RESOURCE

Jurisdiction of the Courts of Appeal

First
Maine
Maryland
Massachusetts
New Hampshire
Rhode Island
Puerto Rico

Second
Connecticut
New York
Vermont

Third
Delaware
New Jersey
Pennsylvania
Virgin Islands

District of Columbia
Washington, D.C.

Fourth
Arkansas
North Carolina
South Carolina
Virginia
West Virginia

Fifth
Canal Zone
Louisiana
Mississippi
Texas

Sixth
Kentucky
Michigan
Ohio
Tennessee

Seventh
Illinois
Indiana
Wisconsin

Eighth
Colorado
Iowa
Minnesota
Missouri
Nebraska
North Dakota
South Dakota

Ninth
Alaska
Arizona
California
Hawaii
Idaho
Montana
Nevada
Oregon
Washington
Guam

Tenth
Kansas
New Mexico
Oklahoma
Utah
Wyoming

Eleventh
Alabama
Florida
Georgia

Federal
U.S. Court of Federal Claims

d. Bankruptcy court. In certain situations, a bankruptcy court may have jurisdiction over tax matters. Since the filing of a bankruptcy petition prevents creditors from filing a claim against a person, a tax dispute may be settled by the bankruptcy court.

e. Locating court cases. Tax cases can be found in a variety of different official and unofficial sources. The instructor can utilize Figure 2-1 in these Lecture Notes to explain the different sources in which tax cases are published.

14. The appellate process. The role of the appellate court is limited to a review of the trial record compiled by the trial court. The appellate process usually involves a determination of whether the trial court applied the proper law in arriving at its decision.

a. Bound by findings of facts unless they are clearly erroneous.

b. The appellate court may approve (affirm) or disapprove (reverse) the lower court's findings, or it may send the case back for further consideration (remand).

c. District Courts, the Tax Court, and the Court of Federal Claims must abide by the precedents set by the Court of Appeals of jurisdiction.

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d. All courts must follow the decision of the U.S. Supreme Court.

e. Since the *Golsen* decision [*Jack E. Golsen*, 54 T.C. 742 (1970)], the Tax Court decides a case as it believes the law should be applied only if the Court of Appeals has not passed on the issue.

f. The U.S. Supreme Court grants certiorari to resolve a conflict among the Courts of Appeals or where the tax issue is extremely important.

(1) The granting of a Writ of Certiorari indicates that at least four of the nine members of the Supreme Court believe that the issue is of sufficient importance to be heard by the full Court.

15. Judicial citations. Judicial citations usually follow a standard pattern: case name, volume number, reporter series, page or paragraph number, court, and year of the decision.

a. U.S. Court of Federal Claims. Prior to October 1, 1982, the Claims Court was called the Court of Claims. Beginning on October 29, 1992, the Claims Court underwent a further name change. The new designation, U.S. Court of Federal Claims, begins with Volume 27 of the former *Cl.Ct.* (West citation) now abbreviated as *Fed.Cl*. Claims Court and Court of Federal Claims decisions are now appealable to the Federal Circuit, whereas they were previously appealable only to the Supreme Court.

(1) *Court of Claims Reporter*. The *Court of Claims Reporter* series, published by the U.S. Government Printing Office, is the primary source of these former Court of Claims cases.

(2) *Federal Reporter and Claims Court Reporter*. Court of Claims cases from 1929 to 1932 and from 1960 to September 1982 can be found in the *Federal Reporter*, published by West. Beginning in October 1982, these Claims Court decisions are published in West's *Claims Court Reporter*.

(3) *Federal Claims Reporter*. Beginning with Volume 27 on October 30, 1992, the name of the reporter is changed to the *Federal Claims Reporter*.

b. U.S. Tax Court. Often called the "poor person's court" because a taxpayer does not have to pay the proposed deficiency in order to bring a case before the court.

(1) Organization and authority. In 1969, the Tax Court transitioned from an administrative court to a judicial court. Nineteen regular judges produce both "regular decisions" and so-called "memorandum decisions."

(2) Tax Court decisions. Regular Tax Court decisions are published by the U.S. Government Printing Office as the *Tax Court of the United States Reports*.

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c. Memorandum decisions. Memorandum decisions are reproduced by the government in mimeograph form only. However, RIA publishes RIA (formerly Prentice-Hall) T.C. Memorandum Decisions and Commerce Clearing House makes them available as Tax Court Memorandum Decisions.

Other Sources of the Tax Law

16. Tax treaties. Tax legislation enacted in 1988 provided that neither a tax law nor a tax treaty takes general precedence. If there is a conflict between the Code and a treaty, the most recent item takes precedence.

17. Tax periodicals.

    a. Can shorten the research time needed to resolve a tax issue.

WORKING WITH THE TAX LAW—TAX RESEARCH TOOLS

Commercial Tax Services

18. Loose leaf tax services. A number of publishers provide loose leaf (or other currently supplemented) tax services for practitioners. Some of the major services include:

    a. Research Institute of America's (RIA) *United States Tax Reporter* (formerly P-H's *Federal Taxes*).

    b. Commerce Clearing House's (CCH) *Standard Federal Tax Reporter*.

    c. RIA's *Federal Tax Coordinator 2d.*

    d. *Mertens Law of Federal Income Taxation* (Clark, Boardman, Callaghan).

    e. *Federal Income, Gift, and Estate Taxation* (Warren, Gorham, and Lamont).

    f. Bureau of National Affair's (BNA) *Tax Management Portfolios*.

    Many of these services are also available electronically.

19. Assessing tax services. In terms of assessing the major tax services, the following points are relevant:

    a. Except for arrangement of the subject matter, there is not much difference between CCH's *Standard Federal Tax Reporter* and RIA's *United States Tax Reporter*.

    b. RIA's editorial content is generally more detailed than CCH's editorial content. The RIA editorial materials also contain more detailed tax-planning discussions.

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However, many practitioners feel that rule coverage and case law background are more extensive in CCH.

c. Mertens is an excellent source if the emphasis is on background material for in-depth research. Mertens is, however, difficult reading due to its legalistic style. Also, updating is less frequent than most other services and not as accessible.

d. BNA's *Tax Management Portfolios* (TMPs) comprise a series of monographs on various subjects. As the treatment of a subject usually is exhaustive, a portfolio can serve as a convenient means of familiarizing the reader with the material. Note that portfolios are generally updated on a three-year cycle.

e. In summary, the day-to-day, all-purpose services are CCH and RIA. Mertens and the TMPs are useful for more extensive research and background.

Using Online Tax Services

20. RIA's *Checkpoint* and CCH's *Intelliconnect* are commonly used online tax research services. (Westlaw and Lexis are more commonly used by law firms.) Both services provide access to primary and secondary sources of tax law.

21. Internet. See Exhibit 2.7 in the text.

22. Key ways to use an online tax service.

    a. Choose keywords for the search carefully.

    b. Take advantage of connectors.

    c. Be selective in choosing a database.

    d. Use a table of contents, index, or citation approach.

Noncommercial Online Tax Services

23. Search Home pages.

24. Search news groups.

WORKING WITH THE TAX LAW—TAX RESEARCH

25. Definition of research. Tax research is the method whereby one determines the best available solution to a situation that possesses tax consequences. In other words, it is the process of finding a professional conclusion to a tax problem. The problem might originate either from completed or proposed transactions. Tax research involves the following procedures (see Exhibit 2.8 in the text):

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a. Identifying and refining the problem.

b. Locating the appropriate tax law sources.

c. Assessing the validity of the tax law sources.

d. Arriving at the solution or at alternative solutions with due consideration given to nontax factors.

e. Effectively communicating the solution to the taxpayer or the taxpayer's representative. See Exhibits 2.9 and 2.10 in the text.

(1) A short review of the fact pattern that raises the issue.

(2) A clear statement of the research question/issue.

(3) A review of the pertinent tax law sources (e.g., Code, administrative sources, judicial authority).

(4) Any assumptions made in arriving at the conclusion.

(5) The conclusion recommended and the logic or reasoning supporting it.

(6) The references consulted in the research process.

f. Following up on the solution in light of new developments.

Identifying the Problem

26. Problem identification must start with a compilation of the relevant facts involved. In other words, all of the facts that may have a bearing on the problem must be gathered.

Refining the Problem

27. Use new facts to refine the tax problem.

Locating the Appropriate Tax Law Sources

28. Once the problem is clearly defined, we index the volume of a hard copy tax service or a keyword search on an online tax service.

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Assessing the Validity of the Tax Law Sources

29. Once a source has been located, the next step is to assess it in light of the problem at hand. Proper assessment involves careful interpretation of the tax law with consideration given to its relevance and validity.

30. Interpreting the Internal Revenue Code. This is the greatest challenge for the IRS. The language of the Code is difficult to comprehend fully.

31. Assessing the validity of a Treasury Regulation.

    a. Give the Code equal weight when dealing with taxpayers and their representatives.

    b. Proposed regulations are not binding.

    c. The burden of proof is on the taxpayer.

    d. If the taxpayer loses the challenge, then a 20% negligence penalty may be imposed.

    e. Final regulations provide instructions about internal management.

    f. Interpretive regulations are hard and solid and almost impossible to overturn.

    g. In some Code sections, Congress has given the Treasury Secretary the authority to prescribe Regulations to carry out the details of administration.

    h. Apply the legislative reenactment doctrine.

32. Assessing the validity of other administration sources of the tax law. In any dispute with the IRS on the interpretation of tax law.

33. Assessing the validity of judicial sources of the tax law.

    a. The higher the level of the court that issued a decision, the greater the weight accorded to that decision.

    b. More reliance is placed on decisions of courts that have jurisdiction in the area where the taxpayer's legal residence is located.

    c. A Tax Court Regulator decision carries more weight than a memorandum decision, because the Tax Court does not consider memorandum decisions to be binding.

    d. A Circuit Court decision where certiorari has been requested and denied by the U.S. Supreme Court carries more weight than a Circuit Court decision that was not appealed.

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e. A decision that is supported by cases from other courts carries more weight than a decision that is not supported by other cases.

f. The weight of a decision also can be affected by its status on appeal.

34. Assessing the validity of other sources.

a. In Notice 90-20, the IRS expanded the list of substantial authority for purposes of the accuracy-related penalty in § 6662 to include a number of secondary materials.

Arriving at the Solution or at Alternative Solutions

Communicating Tax Research

35. A good tax research communication should contain:
- A clear statement of the issue.
- A short review of the facts that raise the issue.
- A review of the pertinent tax law source.
- Any assumptions made in arriving at the solution.
- The solution recommended and the logic or reasoning supporting it.
- The references consulted in the research process.
- It should tell the audience what was researched, the results of the research, and the justification for the recommendation made. (See Exhibits 2.9 and 2.10 in the text.)

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Table 1
Primary and Secondary Tax Law Sources

	Primary	Secondary
Sixteenth Amendment to Constitution	X	
Tax Treaty	X	
Internal Revenue Code Section	X	
U.S. Supreme Court Decision	X	
U.S. Circuit Court of Appeals Decision	X	
Tax Court Memorandum Decision	X	
Tax Court Regular Decision	X	
U.S. District Court Decision	X	
U.S. Court of Federal Claims Decision	X	
Small Cases Division of U.S. Tax Court	X**	
Final Regulation	X	
Temporary Regulation	X*	
Proposed Regulation	X***	
Revenue Ruling	X	
Revenue Procedure	X	
Senate Finance Committee Report	X	
Bluebook		X
Letter Ruling		X
Technical Advice Memorandum		X
Actions on Decisions		X
Determination Letter		X
Harvard Law Review article		X
Field Service Advice		X
General Counsel Memorandum		X

* Can be outstanding for three years at most.

The categorization of a tax law source as a primary or a secondary source is not black and white. All of the sources categorized as primary in the above table are so categorized because all can be relied on to defend against the application of penalties by the IRS. However, note the following:

** The Tax Court indicates that Small Cases Division opinions should not be used or cited as precedent. As such, these decisions could be categorized as secondary sources.

*** Proposed regulations are not binding. That is, a taxpayer is not required to follow the guidance in the proposed regulation unless (or until) the regulation becomes final. This could lead to the categorization of a proposed regulation as a secondary source.

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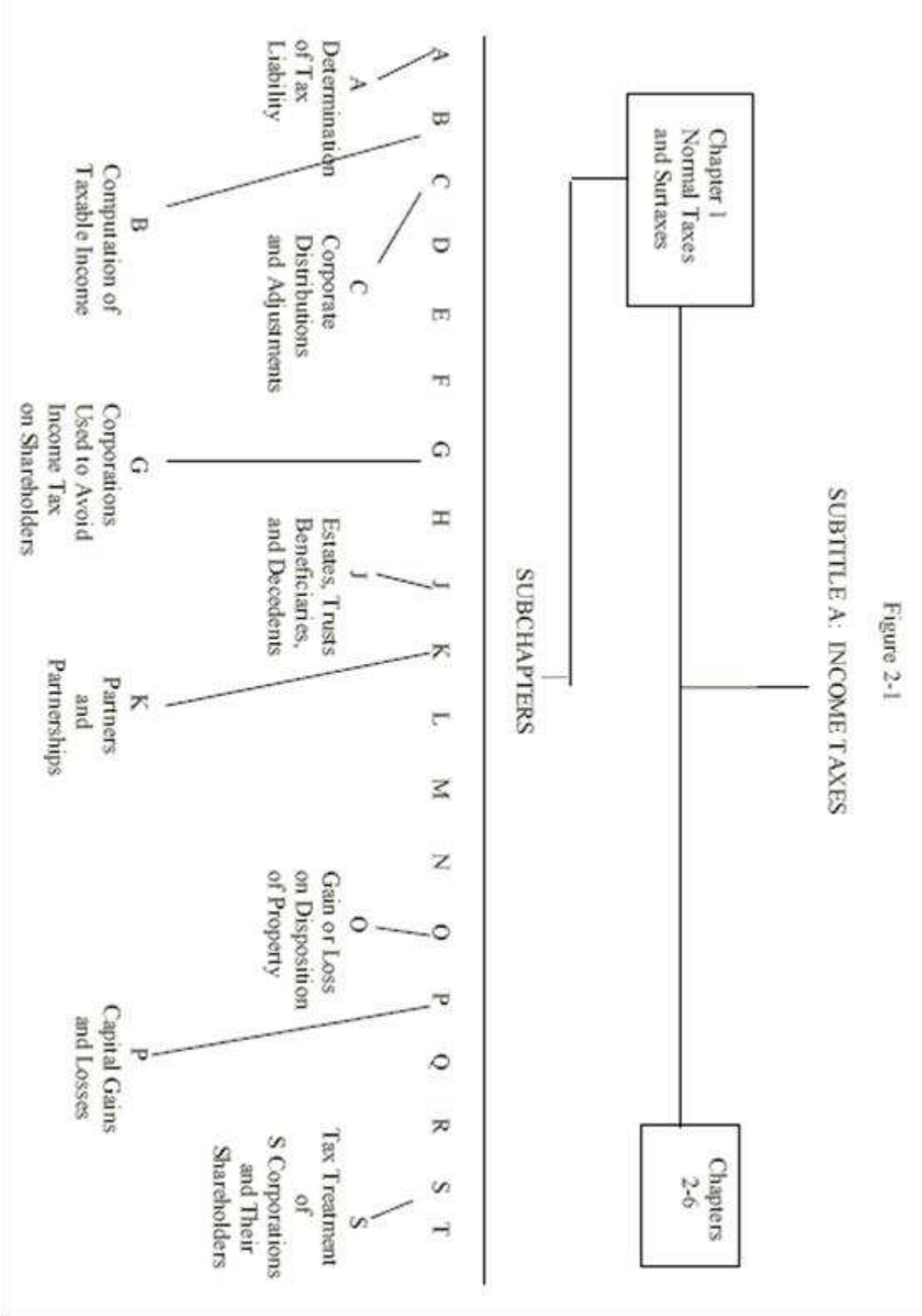

Figure 2-1

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Figure 2-2
Location of Judicial Sources

	USTC Series	AFTR Series	F.Supp. Series	F.3d Series	Cls.Ct. Series	S.Ct. Series[a]
U.S. District Courts (tax cases)	Yes	Yes	Yes	No	No	No
U.S. Tax Court[b]	No[c]	No[c]	No	No	No	No
U.S. Court of Federal Claims[d] (tax cases)	Yes	Yes	No[e]	Yes[e]	Yes[e]	No
U.S. Courts of Appeal (tax cases)	Yes	Yes	No	Yes	No	No
U.S. Supreme Ct. (tax cases)	Yes	Yes	No	No	No	Yes
U.S. District Courts[f] (all cases)	No	No	Yes	No	No	No
U.S. Courts of Appeal (all cases)	No	No	No	Yes	No	No
U.S. Supreme Court (all cases)	No	No	No	No	No	Yes

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Notes for Figure 2-2:

a Answers also apply to the *United States Supreme Court Reports* (abbreviated U.S.) and to the *United States Reports*, *Lawyers Edition* (abbreviated L.Ed.).

b Regular (not memorandum) decisions are published by the U.S. Government Printing Office (GPO) in *Tax Court of the United States Reports*.

c Both CCH and RIA (formerly P-H) have separate reporters for Regular, Memorandum, and Small Cases Division decisions of the U.S. Tax Court.

d All decisions (both tax and nontax) of the U.S. Court of Federal Claims are published by the U.S. GPO in the *Claims Court Reporter Series*. From 1960 to October 1, 1982, Court of Claims decisions were published in the *Court of Claims Reporter Series*.

e From 1932 to 1960, the Court of Claims decisions were published in the *F.Supp. Series*. Beginning October 1982, the Claims Court decisions are published in the *Claims Court Reporter*. Beginning on October 30, 1992, the Claims Court underwent a further name change. The new designation, U.S. Court of Federal Claims, begins with Volume 27 of the former *Cl.Ct.* (West citation) now abbreviated as *Fed.Cl*.

f "All cases" has reference to nontax as well as tax decisions. Thus, it would include such varied issues as interstate transportation of stolen goods, civil rights violations, and anti-trust suits.

WORKING WITH THE TAX LAW—TAX PLANNING

36. Tax research and tax planning are inseparable.
    - The primary purpose of effective tax planning is to reduce the taxpayer's total tax bill.
    - The secondary objective of effective tax planning is to reduce or defer the tax in the current tax year.

Nontax Considerations

37. Tax considerations may impair the exercise of sound business judgment by the taxpayer. The goal should be a balance that recognizes the significance of taxes, but not beyond the point where planning detracts from the exercise of good business judgment.

Components of Tax Planning

38. Avoid the recognition of income.

39. Defer the recognition of income.

40. Convert the classification of income.

41. Choose the business entity with the desired tax attributes.

42. Preserve formalities by generating and maintaining supporting documentation.

43. Act in a manner consistent with the intended objective.

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Tax Avoidance and Tax Evasion

44. Avoidance versus evasion. There is a fine line between legal tax planning and illegal tax planning—tax avoidance versus tax evasion. However, the consequences of the two are as vast as the difference between a lightning bug and lightning.

    a. Tax avoidance. Tax avoidance is merely tax minimization through legal techniques. In this sense, tax avoidance becomes the proper objective of all tax planning.

    b. Evasion. Evasion, while also aimed at the elimination or reduction of taxes, connotes the use of subterfuge and fraud as a means to an end.

Follow-Up Procedures

Tax Planning—A Practical Application

TAXATION ON THE CPA EXAMINATION

45. The CPA examination has changed from a paper-and-pencil exam to a computer-based exam with increased emphasis on information technology and general business knowledge. The 14-hour exam has four sections, and taxation is included in the three-hour Regulations section.

46. Each exam section includes multiple-choice questions and two other sections that have short task-based simulation questions. The Regulations section is 60% Taxation and 40% Law & Professional Responsibilities.

47. Candidates can learn more about the CPA examination at www.cpa-exam.org. This online tutorial site's topics include:
    - Common tools.
    - Navigation.
    - Form completion.
    - Numeric entry.
    - Research questions.
    - Authoritative literature search.
    - Written communication.

RESEARCH PROBLEMS

Solutions to end-of-chapter Research Problems are located in the Solutions Manual.

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IN-CLASS EXERCISES

Q1. The shareholders of Red Corporation and Green Corporation want assurance that the consolidation of the corporation into Blue Corporation will be a nontaxable reorganization.

Solution:
The proper approach is to request that the National Office of the IRS issue a letter ruling concerning the income tax effect of the proposed transaction.

Q2. Chris operates a barbershop in which he employs eight barbers. To comply with the rules governing income tax and payroll tax withholding, Chris wants to know whether the barbers working for him are employees or independent contractors.

Solution:
The proper procedure is to request a determination letter on their status from the appropriate Area Director.

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