Pearsons Federal Taxation 2025 Comprehensive 38th edition Richardson Solutions Manual

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Chapter I:1

An Introduction to Taxation

Learning Objectives

After studying this chapter, the student should be able to:

1. Discuss the history of taxation in the United States.
2. Describe the three types of tax rate structures.
3. Describe the various types of taxes.
4. Discuss the criteria for a "good" tax structure, the objectives of the federal income tax law, and recent tax reform proposals.
5. Describe the tax entities in the federal income tax system.
6. Identify the various tax law sources and understand their implications for tax practice.
7. Describe the legislative process for the enactment of the tax law.
8. Describe the administrative procedures under the tax law.
9. Describe the components of a tax practice.
10. Understand the importance of computer applications in taxation.

Areas of Greater Significance

1. For an introductory course in taxation, two of the topics in this chapter should be emphasized. The first topic to be emphasized is the sources of tax law (both primary and secondary). The student should understand that in spite of the black and white rule approach in much of the following material, a tax practitioner may spend a considerable amount of time dealing with issues that are not clear cut.
2. Second, the administration of the tax law should be emphasized. An understanding of how the Internal Revenue Service operates is valuable to each student, even if the only future application is with regard to the student's own individual tax return.

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Areas of Lesser Significance

In the interest of time, the instructor may determine that the following areas are best covered by student reading, rather than class discussion:

1. History of Taxation in the United States
2. Other Types of Taxes
3. Criteria for a Tax Structure
4. Objectives of the Federal Income Tax Law

Problem Areas for Students

The following areas may prove especially difficult for students:

1. The relative weight to be given to various governmental interpretations of the tax law (i.e., Treasury Regulations vs. Tax Court cases).
2. The mechanics and thought process in doing tax research. An instructor who will use tax research as a significant pedagogical tool may want to spend considerable time on the topic at this point. It is very difficult for a student to understand tax research without doing tax research. (See Chapter I:15.)

Highlights of Recent Tax Law Changes

The following items of tax law have changed since the 2024 edition of this chapter:

1. The income levels for tax rates for ordinary income, long-term capital gains, dividend income, and income of estates and trusts have increased. (See Quick Reference.)
2. The ceiling amount for paying the full amount of payroll taxes has increased to $168,600 ($160,200 in 2023).
3. The annual exclusion for gifts has increased to $18,000 ($17,000 in 2023).
4. The unified transfer tax equivalent has increased to $13,610,000 ($12,920,000 in 2023).
5. The standard deduction for each filing status has increased. (See Quick Reference.)

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Teaching Tips

1. If you want to teach tax research in the introductory class, it would be best to assign a comprehensive tax research problem to solidify concepts taught in class.

2. When teaching tax law sources, it is important to clarify to the students the relative priority of the many different sources.

Lecture Outline

I. Types of Tax Rate Structures

1. The Structure of Individual Income Tax Rates (Example I:1-1, I:1-2)

    a. Possible tax rate structures are progressive, proportional (flat tax), or regressive. The current federal tax system is progressive (10%-37%).

2. Corporate Tax Rates

    a. The tax rate for regular corporations (C corporations) is flat (21%).

3. Marginal, Average, and Effective Tax Rates for Taxpayers (Example I:1-4, I:1-5)

    a. Marginal tax rates may vary significantly from the nominal schedule rates. For example, even though the nominal maximum individual rate is 37%, the realized marginal rate is higher because of health care taxes.

    b. Because the federal income tax for individuals is progressive, average tax is always below marginal tax.

    c. Effective tax rates are likely the lowest of the three calculations because economic income exceeds taxable income.

4. Determination of Taxable Income and Tax Due

    a. Taxable income for all types of taxpayers is calculated by subtracting allowable exclusions and deductions from total income. The tax or refund due is calculated by subtracting allowable credits and/or prepayments from the gross tax liability resulting from applying applicable tax rates to taxable income.

II. Entities in the Federal Income Tax System

1. Taxpaying entities are individuals (Example I:1-13) and C corporations (Example I:1-14). If trusts and estates do not fully distribute their taxable income, they may pay tax.

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2. Flow-through entities are sole proprietorships, partnerships (Example I:1-18), S corporations, limited liability companies and limited liability partnerships, and trusts and estates (to the extent that the trust's or estate's income is distributed) (Example I:1-23).

III. Tax Law Sources (Topic Review I:1-3; Instructor Aid I:1-1)

1. Legislative tax law sources include the Internal Revenue Code and Congressional Committee Reports.

2. Executive (Administrative) tax law sources include proposed, temporary, and final Treasury regulations and IRS revenue rulings, revenue procedures, private letter rulings, technical advice memoranda, and information releases.

3. Judicial tax law sources include various levels of court decisions.

IV. Enactment of a Tax Law (Table I:1-2)

1. The procedures for enactment of tax legislation are the same as those for any other federal legislation, with the exception that all revenue measures are constitutionally required to be introduced in the House of Representatives. These procedures include deliberations by the House Ways and Means Committee, the Senate Finance Committee, and the Joint Conference Committee. The committee reports produced during these deliberations are valuable sources of legislative intent used in governmental and taxpayer interpretation of the enacted legislation.

2. The political process affects tax legislation as it proceeds through the House of Representatives and the Senate toward the President's signature. The economic, social, and revenue priorities of the legislators (and their constituencies) affect the final product. Also, efforts to reduce the budget deficit in recent years have had an impact on annual tax legislation.

V. Administration of the Tax Law and Tax Practice Issues (Instructor Aid I:1-2)

1. Organization of the Internal Revenue Service

    a. Important personnel in the IRS (in descending authority) are the Commissioner of the Internal Revenue, deputy and assistant commissioners, regional commissioners, and district directors.

    b. Unresolved disputes between taxpayers and the IRS may result in litigation. Tax litigation in Tax Court is handled by the office of the Chief Counsel. Tax litigation in a U.S. District Court and the U.S. Claims Court is handled by attorneys in the Department of Justice.

2. Selection of Returns for Audit (Example I:1-25; Question I:1-29)

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a. With the use of computer analysis and professional judgment, taxpayer returns are selected for additional correspondence, office audit, or field audit. Mathematical errors and certain matching problems (e.g., the amount of interest on a Form 1099 received by the IRS does not match the amount of interest reported by the taxpayer) can generally be resolved by correspondence.

b. In an office audit, the taxpayer is asked to bring documentation to the IRS office to substantiate income, deduction, and/or credit items on the taxpayer's return. More complex audits are handled by a field audit where the IRS agent goes to the taxpayer's place of business or to the office of the taxpayer's tax professional.

c. Disputes between IRS agents and taxpayers may be resolved with the IRS Appeals Division. While the overall individual audit rate is less than 1%, individuals with relatively large amounts of income and deductions are significantly more likely to be audited. If a return contains a frequently disputed item (e.g., home office deduction), the likelihood of audit also increases.

3. Statute of Limitations (Problem I:1-48)

a. The normal statute of limitations (i.e., how long the IRS has to examine the return) is three years from the due date of the return (or when the return is actually filed if late). The statute of limitations is extended to six years if more than 25% of gross income is omitted on the return. There is no statute of limitations if the taxpayer committed fraud or failed to file a return.

b. The applicable statute of limitations may be extended by mutual agreement between the taxpayer and the government. Reticent taxpayers are encouraged to extend the statute of limitations when the alternative is an immediate unfavorable notice of deficiency. These varying lengths of statutes of limitation also cause a record-keeping problem for taxpayers. How can a taxpayer disprove an IRS claim of fraud without keeping tax records indefinitely?

4. Interest and Penalties (Example I:1-27)

a. Interest and penalties may apply to taxes due and other taxpayer noncompliance. The deductibility of interest paid will be determined under the normal interest deductions rules. Penalties for failure to file, failure to pay, negligence, fraud, etc., are not tax deductible.

VI. Components of a Tax Practice

1. Tax Compliance and Procedures

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a. The preparation of tax returns remains a major component of most tax practices. Some major firms have a separate department to deal with tax compliance.

2. Tax Research

   a. The tax research process involves determination of the facts, identification of the problem, determination of the best solution and communication to the client. (See Chapter I:15 for an in-depth discussion of tax research.)

3. Tax Planning and Consulting

   a. Much of the tax professional's value to a client may be in the planning and consulting areas. Minimizing taxes paid and maximizing after-tax cash flows, while accommodating clients' desires, is a much sought-after commodity in today's complex tax environment.

4. Financial Planning

   a. Some tax professionals have added financial planning to their list of services offered. Items analyzed include insurance coverage, investment strategies, and retirement planning.

Court Case Briefs

Alfred Ficalora v. CIR, 55 AFTR 2d 85-473, 85-1 USTC & 9103 (2nd Cir., 1984).

In 1980, an employee of the New York telephone company challenged the constitutional authority of Congress and the Tax Court to impose a direct tax on his wages without apportionment to the States. He cited Article I, Section 9, clause 4 of the U.S. Constitution which prohibits a direct tax without apportionment. The taxpayer further relied on the case of *Pollock v. Farmer's Loan and Trust Co.*, 3 AFTR 2602, 15 S. Ct. 912 (USSC, 1895) which states that a tax on the income from real and personal property was invalid without apportionment.

The Supreme Court in *Pollock*, however, had stated explicitly that a tax on one's employment was not a direct tax and did not require apportionment. Further, the Sixteenth Amendment to the U.S. Constitution gave Congress the authority to tax income without apportionment. The court found that the taxpayer had ignored the developments in Constitutional law over the last ninety years and upheld the deficiency and penalties assessed against him.

Walter G. Pietsch v. CIR, 26 AFTR 2d 70-5847, 70-2 USTC & 9718 (2nd Cir., 1970).

Mr. Pietsch filed his 1968 income tax return, but denied liability for the portion of the tax that was associated with funding the military operation of the United States in the Vietnam conflict.

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The taxpayer sought a declaration from the court that American participation in Vietnam was unconstitutional and asked the court to enjoin the federal officials from collecting the tax.

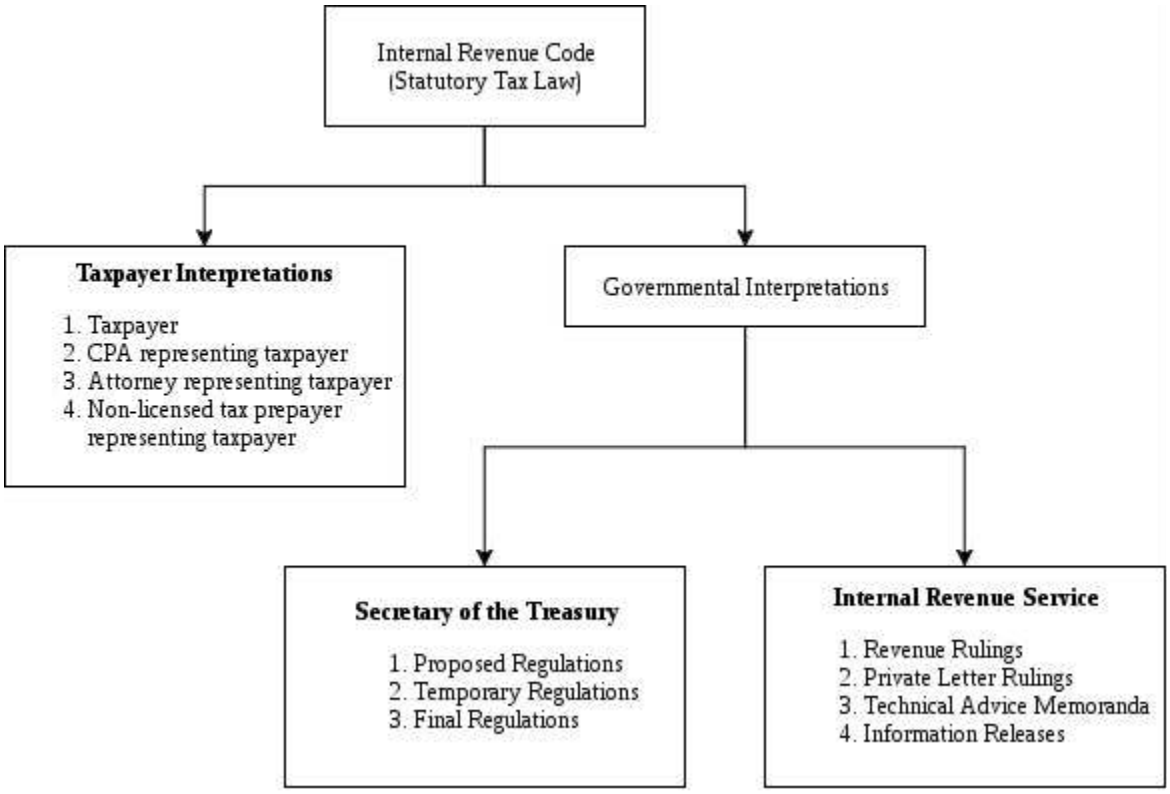
The suit was dismissed for failure to state a claim (the taxpayer had not yet paid the tax). The court stated further that Mr. Pietsch was most unlikely to prevail in a refund suit (commenced after the tax was paid) because he did not attack the validity of the tax itself, but rather the use of it.

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Instructor Aid I:1-1

Tax Law Interpretations

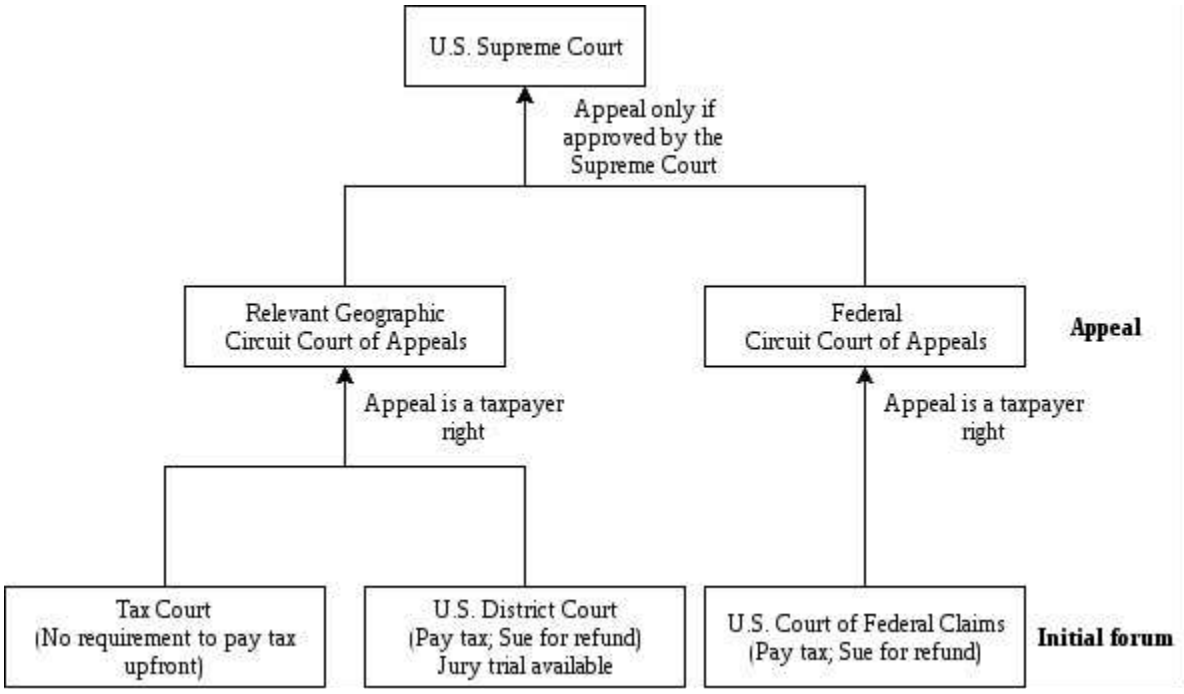


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Instructor Aid I:1-2

Tax Litigation from the Taxpayer Perspective



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Chapter I:1

An Introduction to Taxation

Discussion Questions

I:1-1 The Supreme Court held the income tax to be unconstitutional in 1895 because the income tax was considered to be a direct tax. At that time, the U.S. Constitution required that an income tax be apportioned among the states in proportion to their populations. This type of tax system would be extremely difficult to administer because different rates of tax would apply to individual taxpayers depending on their states of residence. p. I:1-2.

I:1-2 The pay-as-you-go withholding was needed in 1943 to avoid significant tax collection problems as the tax base broadened from 6% of the population in 1939 to 74% in 1945. Pay-as-you-go permitted the federal government to deduct taxes directly out of an employee's wages. p. I:1-3.

I:1-3 Under a progressive tax rate structure, the tax rate increases as the taxpayer's income increases. Currently, for 2024, tax rates of 10%, 12%, 22%, 24%, 32%, 35% or 37% apply depending upon the taxpayer's filing status and taxable income levels. Under a proportional tax rate or "flat tax" structure, the same tax rate applies to all taxpayers regardless of their income levels. Under a regressive tax rate structure, the tax rate decreases with an increase in income level. The concept of vertical equity holds that taxpayers with higher income levels should pay a higher proportion of tax and that the tax should be borne by those who have the "ability to pay." Thus, Congressman Patrick's opposition to the flat tax is philosophically correct; under a flat tax system, all taxpayers pay taxes at the same rate, regardless of the ability to pay. pp. I:1-4 and I:1-5.

I:1-4 It is possible for the government to raise taxes without raising tax rates. Because there are two components in computing a taxpayer's tax, the tax base and the tax rate, taxes can be raised by increasing either the rate or the base. Thus, even though the Governor proclaimed that tax rates have remained at the same level, adjustments to the tax base, such as the elimination of deductions, result in tax increases which can be as much, or more, as increases in tax rates. p. I:1-4.

I:1-5 The marginal tax rate is of greater significance in measuring the tax effect for Carmen's decision. The marginal tax rate is the percentage that is applied to an incremental amount of taxable income that is added to or subtracted from the tax base. Through the marginal tax rate, the taxpayer may measure the tax effect of the charitable contribution to her church. If her marginal tax rate is 24%, she will save 24¢ for each $1 contributed to her church. The average tax rate is simply the total tax liability divided by taxable income. pp. I:1-5 and I:1-6.

I:1-6 Gift and estate taxes are levied when a transfer of wealth (property) takes place and are both part of the unified transfer tax system. The tax base for computing the gift tax is the fair market value of all gifts made in the current year minus an annual donee exclusion of $18,000 (2024) per donee, minus a marital deduction for gifts to spouse and a charitable contributions

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deduction if applicable, plus the value of all taxable gifts in prior years. The tax base for the estate tax is the decedent's gross estate, minus deductions for expenses, and a marital or charitable deduction if applicable, plus taxable gifts made after 1976. pp. I:1-7 through I:1-10.

I:1-7 a. Cathy, the donor, is primarily liable for the gift tax on the two gifts. The children are contingently liable for payment of the gift tax in the event the donor fails to pay.

b. Before considering the unified tax credit equivalent of $13.61 million for 2024, a gift tax results on the two gifts for the current year 2024 computed as follows:

Total gifts	$100,000
Minus: Annual gift tax exclusion ($18,000 x 2 donees)	(36,000)
Gift tax base	$ 64,000

Since Cathy has never made gifts in prior years, no gift tax will be due because of the substantial unified tax credit that is available. pp. I:1-8 and I:1-9.

I:1-8 Carlos would report a taxable gain of $2,000 ($27,000 - $25,000). His tax basis in the stock that he inherited is the fair market value on the date of his father's death. pp. I:1-9 and I:1-10.

I:1-9 a. Most estates are **not** subject to the federal estate tax because of generous credit and deduction provisions, such as the unified tax credit and the unlimited marital deduction. The unified tax credit equivalent for 2024 is $13.61 million. This means that, at a minimum, for decedents dying in 2024, no estate of $13.61 million or less will be subject to the federal estate tax.

b. This is a controversial question that has proponents on both sides of the issue. Those that believe the estate tax should be reduced or eliminated basically argue that the estate tax is a double tax, that is, the property of the decedent has already been subject to income taxation during his or her lifetime and should not be subjected to further taxation at death. On the other hand, proponents of retaining or increasing the estate tax believe in the ability to pay principle. p. I:1-10.

I:1-10 a. Progressive.
b. Progressive.
c. Proportional.
d. Proportional.
e. Proportional. (However, state and local sales taxes are considered regressive when measured against income).
pp. I:1-4 and I:1-5 and I:1-12.

I:1-11 Decrease. When Carolyn operates her business as a sole proprietor, she is considered to be self-employed. A self-employment tax is imposed at the rate of 15.3% for 2024 (12.4% OASDI + 2.9% Medicare) on all of her business income with a ceiling on the non-hospital insurance (OASDI) portion of the tax base of $168,600 in 2024. Carolyn is also entitled to an income tax deduction equal to 50% of the self-employment tax payments if she is self-employed. If she works as an employee, however, the OASDI and Medicare taxes are imposed at the employee level at a rate of 7.65% for 2024. The OASDI is imposed on earned income up to a maximum of $168,600 in 2024 while Medicare taxes have no ceiling. Her employer would have to match Carolyn's OASDI and Medicare taxes. Thus, Social Security taxes are levied at the

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same rate of 15.3% (7.65% on the employee and 7.65% on the employer). If the corporation does not pay Carolyn a salary equal to its earnings, the Social Security taxes will be slightly less than under the sole proprietorship. The hospital insurance portion of the FICA premium continues to apply with no ceiling amount for employees, employers, and self-employed individuals. The rate is 2.9% for self-employed individuals and 1.45% each for employees and employers. p. I:1-11.

I:1-12 a. Property taxes are primarily used by local governments and include both real property taxes (real estate) and personal property taxes (tangible and intangible property).

b. Excise taxes are primarily used by the federal government and are imposed on items such as alcohol, tobacco, telephone usage, and many other goods. While not as extensive as the federal government, many state and local governments impose similar types of taxes.

c. Sales taxes are primarily used by state governments and constitute a major revenue source for many states. Local governments are increasingly using sales taxes as well as states. The local governments frequently tack-on 1¢ or 2¢ to the existing state sales tax rather than imposing a separate sales tax.

d. Income taxes are the primary domain of the federal government and constitutes its major source of revenue. However, many state and local governments now use the income tax in their revenue structures.

e. Employment taxes are primarily used by the federal government. Social security (FICA) taxes are a major source of federal revenue. Unemployment taxes are used by states as a compliment to the federal unemployment compensation tax. pp. I:1-10 and I:1-11.

I:1-13 a. The five characteristics of a "good" tax are equity, certainty, convenience, economy, and simplicity. Equity refers to the fairness of the tax to the taxpayers. A certain tax is one that ensures a stable source of government revenue and provides taxpayers with some degree of certainty concerning the amount of their annual tax liability. Convenience refers to the case of assessment, collectability, and administration for the government and reasonable compliance requirements for taxpayers. An economical tax requires minimal compliance costs for taxpayers and minimal administration costs for the government. Simplicity means the tax system is simple to understand and to comply.

b. 1. The federal income tax meets the first four criteria reasonably well, even though many critics would suggest otherwise. The tax is reasonably fair in that the high-income taxpayers pay the most tax, the low-income taxpayers the least tax. While tax laws are constantly changing, most taxpayers have a pretty good idea of what their taxes are going to be for the tax year and the federal income tax does provide the government with a stable source of revenue. The tax is convenient to pay although compliance requirements for taxpayers have risen steadily over the years. The tax is economical for the government to collect; however, the cost of compliance for taxpayers is much too high as approximately 56% of all taxpayers pay a tax preparer to prepare their tax returns. However, virtually no one would suggest that the federal income tax law is simple. In fact, complexity is one of the law's major flaws.

2. The state sales tax meets the criteria of certainty, convenience, economy and simplicity quite well. However, the sales tax is criticized as not being equitable as it tends to fall more heavily on lower and middle-income taxpayers.

3. Property taxes do not fare well according to the characteristics of a "good" tax. From equity standpoint, the property tax is imposed on property owners without regard to their income situation. Thus, a farmer may have substantial property but little income to pay the

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property tax. Property taxes are certain but clearly not convenient in the sense that they are normally assessed in a lump-sum amount once a year. Property taxes do not meet the economy criteria. Property taxes are rather simple although differences in judgments as to valuation of property are a problem. pp. I:1-12 through I:1-14.

I:1-14 a. Horizontal equity refers to the concept that similarly situated taxpayers should pay approximately the same amount of tax. Vertical equity, on the other hand, refers to the concept that higher income taxpayers should not only pay a higher amount of tax but should pay a higher percentage of tax. Vertical equity is based on the notion that taxpayers who have the "ability to pay" (e.g., higher income taxpayers) should pay more tax than lower income taxpayers.

b. Fairness is an elusive term. Because of widely divergent opinions as to what constitutes fairness, it logically follows that there are also many different and divergent opinions as to what constitutes a "fair" tax structure. p. I:1-13.

I:1-15 Secondary objectives include the following:

a. Economic objectives such as stimulating private investment, reducing unemployment, and mitigating the effects of inflation.
b. Encouraging certain activities such as research and development and small business investment.
c. Social and public policy objectives, (e.g. encouraging charitable contributions and discouraging illegal bribes). pp. I:1-14 and I:1-15.

I:1-16 Probably not. It would be difficult to achieve a simplified tax system and also provide incentives to certain industries as well as achieve social objectives. To achieve a simplified tax system would require the elimination of special purpose provisions, such as with the several consumption tax proposals being forwarded. But consumption taxes generally are considered unfair as they fall disproportionately on the low and middle class. pp. I:1-14 through I:1-16.

I:l-17 Taxpaying entities generally are required to pay income taxes on their taxable income. The major taxpaying entities are individuals and C corporations. Flow-through entities generally do not directly pay income taxes on their taxable income but merely pass the income on to a taxpaying entity. The major flow-through entities are sole proprietorships, partnerships, S corporations, limited liability companies (LLC), limited liability partnerships (LLP), and certain trusts. Some entities do not neatly fall within each category and are actually hybrid entities. S corporations, for example, are subject to income taxes in certain situations, such as taxes on built-in gains, the LIFO recapture tax, etc. Not many S corporations incur these taxes. pp. I:1-16 through I:1-24.

I:1-18 Sally and Tom's taxable income for 2024 would be $110,800, computed as follows:

AGI	$ 140,000
Larger of itemized deductions ($22,000) or standard deduction ($29,200)	(29,200)
Taxable income	$ 110,800

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If Sally and Tom had itemized deductions of $32,000 rather than of $22,000, their taxable income would be $108,000, computed as follows:

AGI	$ 140,000
Larger of itemized deductions ($32,000) or standard deduction ($29,200)	(32,000)
Taxable income	$ 108,000

As can be seen previously, the standard deduction of $29,200 is larger than $22,000 of their itemized deductions, so they obviously would claim the standard deduction. Alternatively, if the itemized deductions were $32,000, their taxable income would be 108,000 ($140,000 - $32,000) as the itemized deductions exceed the standard deduction of $29,200. Taxpayers are allowed to deduct the greater of itemized deductions or the standard deduction. pp. I:1-6, I:1-7, and I:1-17.

I:1-19 To properly respond to Bruin, tax calculations for both Bruin Corporation and John Bean must be made for the year.

$400,000 dividend. If the $400,000 is distributed to John as a dividend, Bruin Corporation would get no deduction for the dividend and would have corporate taxes of $105,000 ($500,000 x 0.21) based on taxable income of $500,000. John would then pay a maximum rate of 20% on the dividend because his taxable income is greater than $518,900 given the tax bracket he is in the 37% bracket starts at taxable income over $609,350 for single taxpayers, so the income taxes due by John on the $400,000 dividend would be $80,000. Thus, the total income taxes would be $185,000 ($105,000 + $80,000).

$400,000 salary. If the $400,000 is distributed to John as a salary, Bruin Corporation would be allowed a deduction and the corporation's taxable income now would be $100,000. The corporate tax on $100,000 is $21,000. John would be required to pay income taxes on the $400,000 at 37%, so the tax would be $148,000. The total income taxes for the year would be $169,000.

As can be seen from the analysis above, the $400,000 salary would result in smaller taxes. This results even though John is in the top 37% tax bracket. The tax savings would be even higher if John were in a lower tax bracket. (Note that this solution ignores the incremental 3.8% tax on net investment income for high income taxpayers, which is discussed in later chapters). pp. I:1-19 and I:1-20.

I:1-20 The term "double taxation" refers to the taxing of the same income twice. This type of taxation typically results from a C corporation paying tax on its taxable income and shareholders paying income tax on any dividends received from the C corporation. The impact of double taxation of C corporations has been substantially reduced by the fact that dividends generally are taxed at a 15% rate with a maximum rate of 20%. An example of double taxation can be seen in Example I:1-15 of the textbook. pp. I:1-19 and I:1-20.

I:1-21 Limited liability companies (LLCs) generally are taxed as partnerships. Therefore, the LLC is not subject to income tax on its taxable income but such income is allocated to the members (owners) of the LLC. Thus, only a single-level of taxation is imposed. The same

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allocation rules that pertain to partnerships also apply to LLCs. Another principle feature of LLCs is limited liability for owners (members) of the LLC. pp. I:1-22 and I:1-23.

I:1-22 To prevent double taxation, the tax law allows partners to increase their basis in the partnership for any income that is allocated to the partner. Since partnership distributions are not subject to taxation if such distributions are less than the partner's basis, double taxation is prevented. Similarly, to prevent double deductions, the tax law requires partners to decrease their basis for any loss or deduction that is allocated to the partner. pp. I:1-21 and I:1-22.

I:1-23 Schedule K-1 is an integral part of both the annual partnership tax return and the S corporation tax return. Partnerships and S corporations use the same allocation system. The K-1 reports a partner's allocable share of partnership ordinary income and separately-stated items, such as dividends, long-term capital gains, etc. A K-1 is prepared for each partner in the partnership and is filed with Form 1065. So, if a partnership has ten partners, there will be ten K-1s that allocate the total partnership income to each partner. A copy of each partner's K-1 is provided to the partners so that they can report the information on their own tax returns. pp. I:1-21 and I:1-22.

I:1-24 Quint's taxable income for 2024 is computed as follows:

Allocable share of PDQ Partnership income ($150,000 x .3333)	$50,000
Other income	15,000
Adjusted gross income (AGI)	$ 65,000
Standard deduction	$(14,600)
Taxable income	$50,450

The $30,000 distribution from the partnership is considered a return of capital and is not taxable to Quint. Since he reports his allocable share of partnership income, if the distribution were taxed again, the result would be double taxation. If the partnership is eligible for the 20% qualified business income (QBI) deduction, Quint would also be allowed a deduction of $10,000 ($50,000 x 0.20) for his share of partnership income. pp. I:1-17 and I:1-21.

I:1-25 Because of the vast volume of tax law sources, it is nearly impossible for any person to have recall knowledge of the entire tax law. Thus, the ability to understand what the relevant sources of tax law are, their relative weight (importance), and where to find the sources are vital to a person working in the tax area. p. I:1-24.

I:1-26 Even though the Code is the highest authority of tax law sources, the Code contains general language and does not address the many specific situations and transactions that occur. To resolve tax questions concerning specific situations, administrative rulings and court decisions are an integral part of the income tax law. p. I:1-24.

I:1-27 a. Ways and Means Committee (House of Representatives), Senate Finance Committee (U.S. Senate) and the Joint Conference Committee.

b. Committee reports are helpful for two major purposes: (1) to explain the new law before the Treasury Department drafts regulations on the tax law changes, and (2) to explain the intent of Congress for passing the new law. pp. I:1-24 through I:1-26.

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I:1-28 The National Office of the IRS issues revenue rulings to provide guidance to taxpayers on specific factual situations, processes ruling requests from taxpayers (private letter rulings), and prepares Revenue Procedures that assist taxpayers with compliance matters. Of course, the National Office also provides administrative and human resources functions at the top level of the organization. p. I:1-26.

I:1-29 Individuals most likely to be audited include those that may be involved in any of the following situations:

- Individuals who are sole proprietors and incur significant expenses in connection with the trade or business.
- Itemized deductions in excess of an average amount for the person's income level.
- Filing of a refund claim by a taxpayer who has been previously audited and the audit resulted in a substantial tax deficiency.
- Individuals who are self-employed with substantial business income or income from a profession such as a medical doctor. p. I:1-27.

I:1-30 a. Rarely will the IRS review each line of Anya's return. Audits of individual taxpayers generally focus on selected items on the return. Note: In prior years, the IRS had a Taxpayer Compliance Measurement Program (TCMP) where a small number of taxpayers were selected by a random sample and their returns were audited on a line-by-line basis. These audits were primarily for statistical purposes. Currently, this program has been abandoned. However, the IRS now uses the National Research Program (NRP) to select returns for audit. The NRP will update data compiled in the old TCMP audits and develop new statistical models for identifying returns most likely to contain errors.

b. Generally not all items on a return will be audited. All tax returns are initially checked for mathematical accuracy and items that may be considered clearly erroneous. If differences are noted the IRS sends the taxpayer a bill for the corrected amount. Upon an audit of Anya's return, the IRS generally only examines selected items on the return. These items are those that the IRS believes there is a possibility of error. p. I:1-27.

I:1-31 a. The term "hazards of litigation" refers to the probability of winning or losing a case if it goes to court.

b. Because of the possibility that a case may be lost and the cost of litigation, both the IRS and taxpayers frequently settle a case to avoid such possibilities. The IRS may also decide to settle a case because it does not want to establish an unfavorable precedent of cases in a specific area. A taxpayer may settle a case to avoid substantial legal and professional fees. p. I:1-29.

I:1-32 No, just because the taxpayer has filed a return and received a refund, the IRS may still audit a taxpayer. Tax returns that are selected for audit generally are audited a year or two after the return is received by the IRS. p. I:1-28.

I:1-33 a. The statute of limitations remains open indefinitely if a fraudulent return is filed or if no return is filed at all.

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b. The general rule for the disallowance of tax deduction items is that an assessment may be made against the taxpayer within three years from the later of the date the tax return was filed or its due date.

c. A six-year statute of limitations applies if the taxpayer omits an item of gross income that is in excess of 25 percent of the gross income that is reported on the return. p. I:1-28.

I:1-34 The best possible defensibly correct solution is one that is advantageous to the client but is based upon substantial authoritative support (e.g., favorable court cases) even though the position may be challenged upon audit by the IRS. p. I:1-30.

I:1-35 The four principal areas of activity for the profession of tax practice are: tax compliance and procedure, tax research, tax planning and financial planning. Tax compliance and procedure essentially consists of tax return preparation and assisting the taxpayer in dealing with the IRS. Tax research is the process of developing the most defensibly correct solution to a tax problem. Tax planning involves the process of reducing taxes so as to maximize a taxpayer's after-tax return. Financial planning, while not exclusively related to tax, is an area for tax professionals to assist clients with planning for their entire financial affairs. pp. I:1-29 through I:1-31.

I:1-36 a. Because income taxes may exceed 50% of a taxpayer's income (including federal, state, and local income taxes and Social Security taxes), taxes are an extremely important part of the financial planning process. Any financial plan that does not carefully consider taxes is a flawed plan.

b. Because tax professionals see their clients at least once a year at a minimum (preparation of their income tax returns) and are familiar with the client's financial information, this represents a perfect opportunity to perform financial planning. p. I:1-31.

I:1-37 No, the principal goal of tax planning is to maximize a taxpayer's after-tax cash flow, not just the minimization of taxes due. For example, if a taxable investment generates a better return after taxes are paid than a nontaxable investment, the taxable investment is superior even though taxes must be paid. p. I:1-30.

I:1-38 Tax planning involves the evaluation of alternative courses of action. The evaluation of alternative courses of action can be very time-consuming because of the numerous and complex tax calculations necessary to arrive at an optimal solution. Using tax software has become an essential tool in this process because of the speed and accuracy in which tax calculations can be made as well as data analytic methods to analyze large amounts of tax data. pp. I:1-30 and I:1-31. Tax planning and complex tax calculations, as well as tax research are increasingly performed, or at least assisted, by artificial intelligence (AI).

Problems

I:1-39 a.

Income:		
Salary		$100,000
Business income		25,000

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Interest income		10,000
		$135,000
Deductions:		
Business expenses	$9,500	
Itemized deductions	20,000	29,500
Taxable Income		$105,500
Tax		$18,363

Note: Tax-exempt bond interest is not taxable and itemized deductions are greater than the standard deduction amount.

b. Marginal rate = 24% (From tax rate schedule)
Average rate = 17.41% ($18,363/$105,500)
Effective rate = 14.41% ($18,363/($135,000 + $5,000 - $9,500))

c. From a tax planning point of view, the marginal rate is the most important rate because it measures the tax saving from each additional $1 of deduction (or additional tax from each additional $1 of taxable income). pp. I:1-4 through I:1-7 and I:1-17 and I:1-18.

I:1-40. The income tax payable, average tax rate, and marginal tax rate for each amount for 2024 for married couples filing joint income tax returns is as follows:

a. $2,320 + .12($30,000 - $23,200) = $3,136
Average tax rate: $3,136/$30,000. = 10.45%
Marginal tax rate: 12%

b. $10,852 + .22($100,000 - $94,300) = $12,106
Average tax rate: $12,106/$100,000. = 12.11%
Marginal tax rate: 22%

c. $78,221 + .32($425,000 - $383,900) = $91,373
Average tax rate: $91,373/$425,000. = 21.50%
Marginal tax rate: 32%

d. $196,669.50 + .37($800,000 - $731,200) = $222,125.50
Average tax rate: $222,125.50/$800,000 = 27.77%
Marginal tax rate: 37%

Note: This problem clearly demonstrates the progressive nature of the federal income tax. The average tax rate rises from 10.45% to 27.77% in this problem.

I:1-41 a. Their marginal tax rate with $500,000 of taxable income is 35%. However, with an additional $40,000 of deductions, their taxable income drops to $460,000, which would reduce their marginal tax rate to 32% (for 2024, the 35% rate begins when taxable income exceeds $487,450).

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b. Their tax savings using the 2024 Tax Rate Schedules and married filing jointly would be computed as follows:

Tax on $500,000	$ 115,750
Tax on $460,000	(102,573)
Tax savings	$ 13,177

pp. I:1-4 through I:1-7.

I:1-42 Betty's taxable gift for the current year (2024) is $82,000 computed as follows:

Gift to daughter		$100,000
Gift to husband		40,000
Total gifts during year		$140,000
Annual exclusion ($18,000 x 2)	$36,000	
Marital deduction ($40,000 - $18,000)	22,000	(58,000)
Taxable gifts		$82,000

Note: Charitable contributions are not subject to the gift tax. Thus, the contribution to her church is not subject to the gift tax. pp. I:1-8 and I:1-9.

I:1-43 a. The amount of Clay's taxable estate is $8,225,000. This amount is computed as follows:

Gross estate	$8,500,000
Minus: Funeral and Admin. Expenses	(125,000)
Debts	(150,000)
Taxable Estate	$8,225,000

b. The tax base for computing Clay's estate tax is $ 8,225,000, computed as follows:

Taxable estate	$8,225,000
Gifts after 1976	0
Estate tax base	$8,225,000

c. If the tentative estate tax is $3,235,800, no estate tax is due, computed as follows:

Estate tax from rate schedule	$3,235,800*
Minus: Unified tax credit (2024)	
based on an equivalent of $13,610,000	(5,389,800)
Estate tax due	$0

*[$345,800 + .40 (8,225,000 – 1,000,000)]

d. Yes, because the aggregate value of the estate decreased during the six-month period following the date of death, the alternate valuation date may be selected by the administrator. The important factors in deciding whether to use the alternate valuation date are (1) the amount of estate taxes to be saved, and (2) the impact on the beneficiaries' income tax

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situation. However, in this case, the alternate valuation date would not be necessary because the estate tax using date-of-death value is zero.

Note: There can never be a tax refund even if the unified credit is greater than the tax liability.

e. If the gross estate was $18,500,000, the taxable estate and tax base would be $18,225,000 ($18,500,000 - $125,000 - $150,000). The estate tax would be as follows:

Estate tax from rate schedule	$7,235,800
Minus: Unified tax credit (2024)	
based on an equivalent of $13,610,000	(5,389,800)
Estate tax due	$1,846,000

pp. I:1-9 and I:1-10.

I:1-44 a. The corporate tax liability of KT, Inc. for 2024 would be computed as follows:

Gross income	$2,000,000
Expenses: Operating expenses	(800,000)
Taxable income	$ 1,200,000
Corporation tax ($1,200,000 x 0.21)	$ 252,000

The tax liability of Keith and his wife on their individual return for 2024 is as follows:

Dividend from KT, Inc.	$350,000
Other taxable income	130,000
Adjusted Gross Income (AGI)	480,000
Itemized deductions	(40,000)
Taxable income	$440,000
Income tax (joint return rate schedule):	
Taxable income (above)	$440,000
Minus: dividends	(350,000)
Taxable income without dividends	$ 90,000
Tax from rate schedule on $90,000	$ 10,336
Tax on dividends ($350,000 x 15%*)	52,500
	$ 62,836

Thus, the total tax liability for both the corporation (Keith's share of 50%) and Keith and his wife is $188,836 ($126,000 + $62,836).

b. If the consulting business was organized as an LLC, the income taxes would be as follows:

KT, LLC	
Gross income	$2,000,000

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Operating expenses	(800,000)
Taxable income	$1,200,000
Income tax	$ 0

LLCs are flow-through entities and are not subject to income taxes on the entity.

The tax liability of Keith and his wife on their individual return for 2024 is as follows:

Pass-through income from KT, LLC ($1,200,000/2)	$600,000
Other taxable income	130,000
Adjusted gross income (AGI)	730,000
Itemized deductions	(40,000)
Taxable income	$690,000
Income tax (joint return rate schedule, rounded)*	$ 182,250

*Keith would also be subject to self-employment taxes on the $600,000 from KT, LLC. This amount is not shown in this problem. Self-employment taxes are covered later in this textbook.

In this case, as seen from the tax calculations above, when the consulting business is organized as an LLC, income taxes are decreased by $6,586, calculated as the difference between their tax as an LLC of $182,250 minus their tax as a C Corporation of $188,836. This results even though the dividends are taxed at a rate of 15%. Also, the $700,000 of LLC distributions ($350,000 each) are not subject to income taxation. pp. I:1-19 through I:1-23.

Note: This extremely simplified problem is intended to illustrate the effect of double taxation of C corporations and shareholders. Prior to 2018, the tax effect was much more significant. The reduction of C corporation tax rates to 21% (from 35%) has substantially reduced the tax advantage of flow-through entities. However, the 20% deduction for flow-through entities would further enhance the viability of flow-through entities.

I:1-45 Howard and Dawn's taxable income and income tax liability for 2024 is computed as follows:

Dawn's salary		$ 80,000
Allocable share of partnership income ($180,000 x 0.40)		72,000
Qualified dividends ($4,000 + $3,000)		7,000
Net long-term capital gain [($28,000 - $12,000) x 0.40]		6,400
Adjusted gross income (AGI)		$165,400
Larger of itemized deductions or standard deduction:		
Standard deduction, or	$29,200	
Itemized deductions:		
Mortgage interest	$13,000	

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Real estate taxes	6,000		
State and local income taxes	3,300		
Charitable contributions ($1,600 + $3,000)	4,600	26,600	(29,200)
Taxable income			$136,200

Income tax liability (from tax rate schedules, see calculations below)			$ 19,132*
Income tax payments made during the year:			
Tax withheld from salary		$12,500	
Estimated tax payments		10,000	22,000
Refund			$ 2,868

*$136,200 – (7,000 + 6,400) = 122,800; tax	$17,122
Dividends and LTCG: ($13,400 x 0.15)	2,010
Total tax liability	$19,132

Note: The cash distributions of $150,000 are not subject to income taxation for the partners. Also, Howard would likely be subject to self-employment taxes which are substantial. Self-employment taxes are covered in Chapter I:14 of this textbook.
pp. I:1-17 through I:1-19.

I:1-46 Since Paul's return is filed late and the final balance due on the return is paid late (both due on or before April 15, 2025), Paul is subject to further interest and penalties on his 2024 income tax return. Both interest and penalties are computed on the net tax due or, in this case, $8,000 (the difference between the tax liability and the withholdings). The interest and penalties are computed as follows (assuming a 7% interest rate on underpayments on tax and the return is 232 days late):

Interest: $8,000 x 7% x 232/365 = $355.95.

There are two penalties to which Paul would be subject, a failure to file (timely) penalty and a failure to pay the tax (timely) penalty. The late payment penalty is .5% per month to a maximum of 25%; the late filing penalty is 5% per month to a maximum of 25%. However, both penalties are not assessed together. If both penalties apply, the failure to file penalty is reduced by .5%.

Failure-to-pay penalty (0.5% per month to a maximum 25%):
Based on filing the return 9 months late:

Tax due	$8,000.00
Lesser of (a) 0.5% × 9 or (b) 25%	× 4.5%
Failure-to-pay penalty	$ 360.00

Failure-to-file penalty (5% per month to a maximum 25%, reduced by the failure-to-pay penalty for each month both penalties apply):

Tax due	$8,000.00
Lesser of (a) 5% × 9 or (b) 25%	× 25%
Failure-to-file penalty before reduction	$2,000.00

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Failure-to-pay penalty for 5 months*	(200.00)
Failure-to-file penalty	$1,800.00

*0.5% × 5 months × $8,000 = $200.00. Because the 5% per month penalty has a 25% maximum, it applied for only 5 months. See IRM Sec. 8.17.7.3.

Thus, Paul must pay an additional $355.95 of interest plus $2,160.00 ($360.00 + $1,800.00) of penalties for filing the return late, for a total cost of $2,515.95 for filing late. Obviously, Paul would be prudent to file his return in a timely manner. pp. I:1-28 and I:1-29.

I:1-47 a. Of the three individuals, Connie would most likely be audited. Individuals who have unincorporated businesses that produce significant tax losses are likely to get audited by the IRS.

b. Craig is not likely to be audited.

c. Dale is not likely to be audited. However, it is likely that the Form 1099 will be checked against the reported amount and the IRS Center will send Dale a bill for the corrected amount of tax. p. I:1-27.

I:1-48 The statute of limitations will not prevent the IRS from issuing a deficiency assessment for all three years of 2015, 2020, or 2022. Dan's taxes from 2015 can be assessed because the statute of limitations remains open indefinitely if no return is filed.

The $40,000 of unreported gross income from 2020 is taxable. A six-year statute of limitations applies if the taxpayer omits an item of gross income that is in excess of 25% of the reported gross income. In this case reported gross income was $60,000. $40,000 is greater than $15,000 (0.25 x $60,000).

The $600 unsubstantiated business travel deduction is disallowed in 2022 and gross income will be increased in 2022 because an assessment may be made against the taxpayer within three years from the later of the due date or the date the tax return was filed. In this case the omission occurred in 2022. p. I:1-28.

Tax Strategy and Critical Thinking Problem

I:1-49 Pedro is in a good position to begin a gifting program to his children. Since he has such a significant portfolio of stocks and bonds, he could make annual gifts of $18,000 of stocks and bonds in 2024 and future years to each of his children. The effect of these gifts is to shift the dividends and interest from Pedro (at his high rate) to the children (at their low rates) as well as removing these assets from Pedro's estate upon his death. Since the children have no income, the dividends and interest would be taxed to the older two children at the lowest marginal income tax rates.

As will be discussed in Chapter I:2 of this text, the children will be taxed at special rates for much of the income shifted to them per the so-called "kiddie tax." Thus, the shifting of investment income is not effective for children under the age of 18 (or 24 and in college). Also, Pedro and his wife can actually gift $36,000 ($18,000 x 2) per year for each child and over a few years, a sizeable amount of assets can be transferred to the children. To protect the assets, the gifts can be made to trusts rather than directly to the children to ensure that the children do not

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make bad decisions during their youthful years.

There are many other aspects of this type of tax strategy, but this problem is intended to demonstrate both the income and estate tax savings that can be accomplished through the making of annual gifts.

Case Study Problem

I:1-50

- The apartment buildings constitute a rental activity and are subject to the passive activity rules of Section 469 of the Internal Revenue Code. Since Rick's adjusted gross income (AGI) is greater than $150,000 before the loss, he would be unable to currently deduct the losses on his personal income tax return. Therefore, the $100,000 of losses in each of the first three years would not be deductible. However, the losses would be considered as suspended passive losses and would be available as a deduction against the rental income in future years.
- The blueberry farm, while requiring a substantial cash outlay, would not result in as much a loss as Rick believes. The reason is that most of the cash outlays must be capitalized and, if allowed, depreciated over several years rather than deducted currently. The land would not be depreciated at all. Both the equipment and blueberry plants must be capitalized and depreciated. So, while he may not get as much of a current deduction, he still would be able to claim the deductions in future years when the farm begins generating revenue.
- Rick is correct about using appreciated stock as a charitable contribution. If he gave his entire amount of stock to charitable organizations, he would receive a $200,000 charitable deduction in the year of the contribution. He would not be required to recognize any of the appreciation as income on his tax return. See Section 170 of the Internal Revenue Code for details.

Tax Research Problem

I:1-51 In CIR v. Court Holding Co. the main issue was whether the petitioner should have been taxed on the gain realized on the sales of all its assets, or whether the sale was made by its stockholders individually after distribution of the assets to them in complete liquidation. The sole asset in the corporation was an apartment house. All of the outstanding stock was owned by a husband and wife. Negotiations took place between the corporation, a sister and brother-in-law, and lessees of the building to sell the property. Just prior to putting the sale in writing, the corporation's attorney advised the husband and wife that this sale would cause a large tax to the corporation. The next day the corporation declared a "liquidating dividend" which deeded the property to the husband and wife, who in turn surrendered all of their stock. A sales contract was then drawn between the husband and wife and the lessees of the building for sale of the property. The $1,000 that was previously paid to the corporation was given to the husband and wife as a down payment. The property was then conveyed to the lessees.

The Tax Court found that the corporation had not abandoned the sales negotiations. "A sale by one person cannot be transferred for tax purposes into a sale by another by using the latter as a conduit through which to pass title." The Supreme Court upheld the Tax Court's

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findings that the sale was actually a sale by the corporation and the necessary taxes were imposed. The Supreme Court held that the incidence of the transaction depends upon the "substance" of the transaction and that the separate steps previously described should be viewed as a whole transaction.

In U.S. v. Cumberland Public Service Co. the issue was essentially the same. Who actually made the sale, the corporation or the shareholders? The Cumberland Public Service Company was in the business of generating and distributing electric power. A local cooperative began to distribute power in the area serviced by Cumberland. The competing company had more efficient means of generating electricity. Cumberland offered to sell all of its stock to the competing company. The company refused the offer but countered with an offer to buy the transmission and distribution equipment of Cumberland. Cumberland refused because under such a deal it would have been subject to a heavy capital gains tax. Shareholders of Cumberland offered to buy the corporate property and then sell the property to the competing corporation. The Court of Claims found that the shareholders did actually make the sale and that at no time was the corporation ever planning to make such a sale. In addition, the court held that the liquidation and dissolution genuinely ended the corporation's activities and existence. The Supreme Court upheld the Court of Claims findings.

While the Court Holding Co. and Cumberland Public Service Co. cases appear to revolve around very similar facts, the courts have ruled that the steps of such transactions must be explored as well as the end result. The Cumberland Public Service Company was able to show that the liquidation and dissolution genuinely ended the corporation's activities and existence so that the shareholders acted on their own behalf when they executed the previously contemplated sale to the cooperative.

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Chapter C:1

Tax Research

Note: To complete the online research problems for this chapter, textbook users must have access to an Internet-based tax service at their institution. Solutions are provided using CHECKPOINT, when applicable. In some cases, solutions using other tax services may differ.

Discussion Questions

C:1-1 In a closed-fact situation, the facts have occurred, and the tax advisor's task is to analyze them to determine the appropriate tax treatment. In an open-fact situation, by contrast, the facts have not yet occurred, and the tax advisor's task is to plan for them or shape them so as to produce a favorable tax result. p. C:1-2.

C:1-2 According to the AICPA's Statement on Standards for Tax Services No. 1, the tax advisor must promptly inform the taxpayer of the error and advise on corrective measures that should be taken. If the taxpayer refuses to take such recommended actions, the advisor should consider resigning from the engagement. pp. C:1-31 through C:1-33.

C:1-3 When tax advisors speak about "tax law," they refer to the IRC as elaborated by Treasury Regulations and administrative pronouncements and as interpreted by federal courts. The term also includes the meaning conveyed by committee reports. p. C:1-7.

C:1-4 Committee reports concerning tax legislation explain the purpose behind Congress' proposing the legislation. Transcripts of hearings reproduce the testimonies of the persons who spoke for or against the proposed legislation before the Congressional committees. Committee reports are sometimes used to interpret the statute. p. C:1-7.

C:1-5 Committee reports can help resolve ambiguities in statutory language by revealing Congressional intent. They are indicative of this intent. pp. C:1-7 and C:1-8.

C:1-6 The Internal Revenue Code of 1986 is updated for every statutory change to Title 26 subsequent to 1986. Therefore, it includes the post-1986 tax law changes enacted by Congress and today reflects the current state of the law. p. C:1-8.

C:1-7 No. Title 26 deals with all taxation matters, not just income taxation. It covers estate tax, gift tax, employment tax, alcohol and tobacco tax, and excise tax matters. p. C:1-8.

C:1-8 a. Subsection (c). It discusses the tax treatment of property distributions in general (e.g., amount taxable, amount applied against basis, and amount exceeding basis).

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b. Because Sec. 301 applies to the entire chapter, one should look throughout that entire chapter (Chapter 1 of the IRC – which covers Sec. 1 through Sec. 1400U-3) for any exceptions. One special rule – Sec. 301(e) – is found in Sec. 301. This special rule explains the tax treatment of dividends received by a 20% corporate taxpayer. Section 301(f) indicates some of the important special rules found in other IRC sections.

c. Legislative. Section 301(e)(4) authorizes the issuance of Treasury Regulations as may be necessary to carry out the purposes of the subsection. pp. C:1-9 through C:1-10.

C:1-9 Researchers should note the date on which a Treasury Regulation was adopted because the IRC may have been revised subsequent to that date. That is, the regulation may not interpret the current version of the IRC. Discrepancies between the IRC and the regulation occur when the Treasury Department has not updated the regulation to reflect the statute as amended. p. C:1-9.

C:1-10 a. Proposed regulations are not authoritative, but they do provide guidance concerning how the Treasury Department interprets the IRC. Temporary regulations, which are binding on the taxpayer, often are issued after recent revisions to the IRC so that taxpayers and tax advisors will have guidance concerning procedural and/or computational matters. Final regulations, which are issued after the public has had time to comment on proposed regulations, are considered to be somewhat more authoritative than temporary regulations. pp. C:1-9 and C:1-10.

b. Interpretative regulations make the IRC's statutory language easier to understand and apply. They also often provide computational illustrations. In the case of legislative regulations, Congress has delegated the rulemaking on a specific topic (either narrow or broad) to the Treasury Department. However, after the Mayo Foundation case, both types of regulations will have the same authoritative weight. p. C:1-10.

C:1-11 Prior to 2011, courts gave more authority to legislative regulations than to interpretive regulations. However, after the Supreme Court decision in Mayo Foundation, courts will hold both interpretive and legislative regulations to the same standard and will overturn them only in very limited cases. p. C:1-10.

C:1-12 Under the legislative reenactment doctrine, a Treasury Regulation is deemed to have been endorsed by Congress if the regulation was finalized before a related IRC provision was amended by Congress and in the interim, Congress did not amend the statutory provision to which the regulation relates. p. C:1-10.

C:1-13 a. Revenue rulings are not as authoritative as court opinions, Treasury Regulations, or the IRC. They represent interpretations by an interested party, the IRS. p. C:1-12.

b. If the IRS audits the taxpayer's return, the IRS likely will contend that the taxpayer should have followed the ruling and, therefore, owes a deficiency. p. C:1-12.

C:1-14 a. The Tax Court, the U.S. Court of Federal Claims, or the U.S. district court for the taxpayer's jurisdiction. p. C:1-14.

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b. The taxpayer might consider the precedent, if any, existing within each jurisdiction. The taxpayer might prefer to avoid expending cash to pay the proposed deficiency. If so, the taxpayer would want to litigate in the Tax Court. If the taxpayer would like to have a jury trial address questions of fact, he or she should opt for the U.S. district court. pp. C:1-14 through C:1-19, p. C:1-21, and p. C:1-23.

c. Appeals from Tax Court and U.S. district court decisions are made to the circuit court of appeals for the taxpayer's geographical jurisdiction. U.S. Court of Federal Claims decisions are appealable to the Court of Appeals for the Federal Circuit. Appeals from any of the circuit courts of appeals may be brought to the U. S. Supreme Court. pp. C:1-20 through C:1-21.

C:1-15 No. A taxpayer may not appeal a case litigated under the Tax Court's Small Cases Procedure. p. C:1-17.

C:1-16 Tax Court regular and memo decisions have about the same precedential value. Decisions issued under the Small Cases Procedure of the Tax Court have little or no precedential value. pp. C:1-15 and C:1-17.

C:1-17 Yes. The IRS can acquiesce (or nonacquiesce) in any federal court decision that is adverse to the IRS if the IRS decides to do so. In many cases the IRS does not acquiesce or nonacquiesce. p. C:1-17.

C:1-18 In both the AFTR and USTC: decisions of U.S. district courts, U.S. bankruptcy courts, U.S. Court of Federal Claims, circuit courts of appeal, and the U.S. Supreme Court. Tax Court decisions are reported in neither of the two reporters. pp. C:1-16 and C:1-17 through C:1-22.

C:1-19 Prior to 2009, revenue rulings appeared in the weekly Internal Revenue Bulletin (I.R.B.), and twice each year the decisions published in the I.R.B. were bound together and published in the Cumulative Bulletin (C.B.). For pre-2009 rulings, the I.R.B citation was temporary and was replaced by a citation to the C.B. After 2008, the IRS no longer publishes the Cumulative Bulletin. Therefore for current rulings, the initial I.R.B. citation is final. p. C:1-12.

C:1-20 According to the Golsen Rule, the Tax Court will not follow a decision it made earlier, but rather will follow a decision of the circuit court of appeals to which the case under consideration is appealable. As an example, assume that the Tax Court, in a case involving a First Circuit taxpayer, ruled for the taxpayer. The issue had not been litigated earlier. Then, a U.S. district court in Georgia decided a case involving the same issue in favor of another taxpayer. The Eleventh Circuit, however, reversed the decision. Now a taxpayer from the Eleventh Circuit litigates the same issue in the Tax Court. Under the Golsen Rule, the Tax Court will follow the Eleventh Circuit's decision favoring the government. The Tax Court need not follow an appeals court decision if a case was litigated by a taxpayer whose appeal would have been made to any circuit other than the Eleventh. p. C:1-21.

C:1-21 a. The precedent binding upon a California taxpayer would be the Tax Court case. The Tax Court has national jurisdiction. pp. C:1-21 and C:1-23.

b. Under the Golsen Rule, the Tax Court will depart from its earlier decision and follow the Fifth Circuit's decision favoring the government. p. C:1-21.

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C:1-22 a. Congressional Record
b. Internal Revenue Bulletin
c. Tax Court of the United States Reports
d. Federal Register, Internal Revenue Bulletin, and/or Cumulative Bulletin
e. Federal Supplement, American Federal Tax Reports (only tax-related), United States Tax Cases (only tax-related).
f. Not found in an "official" publication; published by tax services
pp. C:1-7, C:1-12 through C:1-14, and C:1-17 through C:1-19.

C:1-23 A tax advisor might find the provisions of a tax treaty useful where a U.S. taxpayer engages in transactions in a foreign country. The United States has tax treaties with many countries. p. C:1-24.

C:1-24 Citators (1) trace the history of the case in question and (2) list other authorities that have cited such case. p. C:1-30.

C:1-25 Revenue rulings, revenue procedures, and judicial decisions. p. C:1-29.

C:1-26 Keyword, index, or citation are the three ways to search in tax service databases. p. C:1-26.

C:1-27 a. The principal primary sources found in CHECKPOINT are as follows:
- IRC
- Treasury Regulations
- Court opinions
- Revenue rulings and procedures
- Letter rulings
- Committee reports
- Tax treaties

b. The principal secondary sources found in CHECKPOINT are as follows:
- Federal Tax Coordinator
- United States Tax Reporter
- Warren, Gorham & Lamont journals and treatises

Secondary sources will differ among the tax services. pp. C:1-26 through C:1-29.

C:1-28 The features (i.e., icons, templates, and command buttons) will vary depending upon the particular tax service/Internet site accessed. Just about all commercial tax databases can be searched by keyword and citation. Some can be searched by table of contents and topic. Most noncommercial tax databases can be searched by keyword. Some can be searched by citation and table of contents.

The advantages of using a commercial tax service (as opposed to a noncommercial service) are broader database scope, greater historical coverage, and more efficient search engines. The principal disadvantage is cost.

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Because of their relative disadvantages, the noncommercial sites should not be regarded as a substitute for a commercial tax service. Access is non-uniform. The scope and breadth of their databases are limited. pp. C:1-26 through C:1-28.

C:1-29 The member should have a good faith belief that his or her position has a realistic possibility of being sustained administratively or judicially on its merits if challenged. p. C:1-31.

C:1-30 Under the AICPA's Statements on Standards for Tax Services (SSTSs), a tax preparer is not obligated to (1) verify client provided information if the information is not suspicious on its face, or (2) update professional advice based on developments following its original conveyance. p. C:1-31.

C:1-31 This answer lists six requirements. Under Circular 230, the practitioner is expected to: (1) base the advice on reasonable assumptions, (2) consider relevant facts and circumstances, (3) identify the facts relevant to the advice, (4) be properly skeptical of representations by the taxpayer and others, (5) relate applicable law and authority to the facts, and (6) not base an opinion on the chances that a transaction will be identified by IRS and subject to audit. p. C:1-30.

C:1-32 Circular 230 is a government issued document that dictates rules for practicing before the IRS. The AICPA's Statements on Standards for Tax Services (SSTSs) are ethical standards issued by the AICPA aimed at tax practitioners. Circular 230 applies only to federal tax issues, and the SSTSs apply to both federal and state issues. Circular 230 only applies to income taxes, and the SSTSs apply to all types of taxes. Finally, Circular 230 does not provide the same depth of ethical guidance found in the SSTSs. p. C:1-30.

Problems

C:1-33 a. Yes. According to Secs. 71(a) and (b), the wife includes $25,000 per year. Also, the divorce agreement must explicitly state that the husband has no liability to make payments after the wife's death. See Sec. 71(b)(1)(D) and Temp. Reg. Sec. 1.71-1T(b), Q-11.

b. Yes. The husband deducts $25,000 per year according to Secs. 215(a) and (b). According to Sec. 62(a)(10), the alimony is deductible for AGI.

c. For alimony agreements after December 31, 2018, Secs. 71 and 215 are repealed. pp. C:1-8 and C:1-26 through C:1-29.

C:1-34 a. Legislative. According to Sec. 385(a), "The Secretary is authorized to prescribe such regulations as may be necessary or appropriate. . . ."

b. Yes. Section 385(a) states that the regulations will be applicable "for purposes of this title." "This title" is Title 26 of the federal statutes. Because Title 26 encompasses all tax statutes, the regulations would be relevant for estate tax purposes. pp. C:1-8 through C:1-10 and C:1-26 through C:1-29.

C:1-35 a. Both rulings hold that contributions to a fund formed to acquire a portrait of a former judge and donated to a governmental agency are deductible under Sec. 170. pp. C:1-12 and C:1-13.

b. Private letter rulings cannot be cited as precedence and apply only to the taxpayer for whom the IRS issued the ruling. pp. C:1-12 and C:1-13.

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c. Revenue rulings can be cited as precedence, and they are relied on by both taxpayers and the IRS for guidance in particular factual situations. pp. C:1-12 and C:1-13.

C:1-36 Sections 355 and 856. The official IRS publication is the Internal Revenue Bulletin, which eventually is incorporated into the Cumulative Bulletin. pp. C:1-12 and C:1-29.

C:1-37 Results might vary as the online service adds or deletes documents, but as of this writing:

a. 443.
b. 203.
c. 87.

C:1-38 The following results were obtained using CHECKPOINT. Results using other tax services may vary.

a. 14.
b. 8 using 'home office' without quotations, 4 with quotes around the term.
c. The results after refining for "home office" are more relevant primarily because 280A also covers issues related to rental and vacation homes and refining the results omits these references. The search within results output produced revenue rulings related to home office issues, and the first result is to a revenue ruling explaining how the IRS would interpret an important Supreme Court case addressing home office deductions. pp. C:1-26 through C:1-28.

C:1-39 a. Acquiescence. See AOD 1986-030, 1986-1 C.B. 1.
b. No. The acquiescence was only with respect to whether a transfer to the taxpayer's spouse is a taxable disposition. pp. C:1-17 and C:1-29.

C:1-40 a. Acquiescence. See AOD 2016-02.
b. The AOD addressed whether the limitation on home mortgage deductions applied on a per property or per taxpayer business. pp. C:1-17 and C:1-29.

C:1-41 a. Nonacquiescence. See AOD 1988-014, 1988-2 C.B.1.
b. Yes. In 2003, the Commissioner withdrew the 1988 AOD and acquiesced. See AOD 2003-001, 2003-2 I.R.B. pp. C:1-17 and C:1-29.

C:1-42 a. Yes. The case was reviewed by the court. No. It was not a unanimous decision. Judges Korner, Swift, and Gerber did not participate. Judge Simpson dissented. pp. C:1-26 through C:1-29.
b. Yes. The decision was entered under Rule 155. p. C:1-17.
c. Yes. The case was reviewed by the Sixth Circuit Court of Appeals. pp. C:1-26 through C:1-29.

C:1-43 a. Yes. The case was reviewed by the court. The decision was not unanimous. Judge Quealy dissented. Judge Tannenwald issued a concurring opinion with which five judges agreed. Judge Chabot issued a dissenting opinion with which three judges agreed, and Judge Nims issued a dissenting opinion with which three judges agreed. pp. C:1-26 through C:1-29.
b. No. The decision was not entered under Rule 155. p. C:1-17.

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c. Yes. The case was reviewed by the Sixth Circuit Court of Appeals in 1982. pp. C:1-26 through C:1-29.

C:1-44 a. National Cash Register Co. v. U.S., 400 F.2d 820, 22 AFTR 2d 5562, 68-2 USTC ¶9576 (6th Cir., 1968).

b. Thomas M. Dragoun, 1984 RIA T.C. Memo ¶84,094 (T.C. Memo 1984-94), 47 TCM 1176.

c. U.S. v. John M. Grabinski, 558 F. Supp. 1324, 52 AFTR 2d 83-5169, 83-2 USTC ¶9460 (DC MN, 1983).

d. U.S. v. John M. Grabinski, 727 F.2d 681, 53 AFTR 2d 84-710, 84-1 USTC ¶9201 (8th Cir., 1984).

e. Rebekah Harkness v. U.S., 469 F.2d 310, 30 AFTR 2d 72-5754, 72-2 USTC ¶9740 (Ct. Cl., 1972). Note that during this period, Court of Claims decisions were published in the Federal Reporter, Second Series. Alternatively, you could give the citation 199 Ct. Cls. 721, which references the Court of Claims Reporter. In the CHECKPOINT citator the name of the case is simply Harkness.

f. Hillsboro National Bank v. CIR, 460 U.S. 370, 51 AFTR 2d 83-874, 83-1 USTC ¶9229 (USSC, 1983).

g. Rev. Rul. 78-129, 1978-1 C.B. 67. pp. C:1-17 through C:1-22.

C:1-45 a. Rev. Rul. 99-7, 1999-1 C.B. 361.

b. Frank H. Sullivan, 1 B.T.A. 93 (1924).

c. Tate & Lyle, Inc., 103 T.C. 656 (1994).

d. Ralph L. Rogers v. U.S., 539 F. Supp. 104, 49 AFTR 2d 82-1160, 82-1 USTC ¶9246 (DC OH, 1982).

e. Norman Rodman v. CIR, 542 F.2d 845, 38 AFTR 2d 76-5840, 76-2 USTC ¶9710 (2nd Cir., 1976). pp. C:1-17 through C:1-22.

C:1-46 a. Circuit Court of Appeals for the Ninth Circuit; page 1198 of Volume 648 of the Federal Reporter, Second Series and page 81-5353 of Volume 48 of the American Federal Tax Reports, Second Series.

b. U. S. Court of Federal Claims; page 455 of Volume 14 of the Claims Court Reporter and paragraph (not page) 9231 of Volume 1 of the 1988 U. S. Tax Cases.

c. Supreme Court; page 13 of Volume 309 of the United States Supreme Court Reports and page 816 of Volume 23 of the American Federal Tax Reports.

d. A U.S. District Court in Texas; page 76 of Volume 441 of the Federal Supplement and page 78-335 of Volume 41 of the American Federal Tax Reports, Second Series.

e. Not a court decision; page 72 of Volume 1 of the 1983 Cumulative Bulletin.

f. Circuit Court of Appeals for Sixth Circuit; page 474 of Volume 568 of the Federal Reporter, Second Series and paragraph (not page) 9199 of Volume 1 of the 1978 U.S. Tax Cases. pp. C:1-16 and C:1-22.

C:1-47 a. A facelift as a deductible medical expense is discussed in ¶K-2109 of the Federal Tax Coordinator. Solutions using other tax services will differ.

b. Section 213.

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c. Generally no. Section 213(d)(9) (effective for tax years beginning after 1990) provides that the cost of cosmetic surgery is not deductible except in certain narrow circumstances. pp. C:1-28 and C:1-29.

C:1-48 No. The regulation does not reflect the amendments to Sec. 302 made by P.L. 96-589, P.L. 97-248, P.L. 98-369, and P.L. 111-325. A caution to this effect appears at the beginning of the regulation. pp. C:1-26 through C:1-29.

C:1-49 a. Casualty losses from termite damage are discussed in ¶M-1743 (Federal Tax Coordinator) and Ann ¶1655.3020 (U.S. Tax Reporter).

b. Authorities include: Rev. Rul. 63-232, 1963-2 C.B. 97; Henry L. Sutherland, 1966 PH T.C. Memo ¶66,155, 25 TCM 822; and Martin A. Rosenberg v. CIR, 42 AFTR 2d 303, 52-2 USTC ¶9377 (8th Cir., 1952). The first two authorities denied a deduction and the third allowed a deduction. Textbook users may find additional authority. pp. C:1-28 and C:1-29.

C:1-50 a. More than 35% of the excess of the value of the decedent's gross estate over the sum of allowable Sec. 2053 and 2054 deductions.

b. No. The regulation indicates the test is more than (1) 35% of the gross estate or (2) 50% of the taxable estate. It does not reflect the P.L. 94-455 or P.L. 97-34 amendments to the IRC. A caution to this effect appears before the beginning of the reprint of the regulations. pp. C:1-26 through C:1-29.

C:1-51 a. 645.

b. 572-3rd - Accounting Methods – Adoptions and Changes.
570- 2nd - Accounting Methods – General Principles.

c. 568-4th.

d. 367.

e. 523-2nd.

p. C:1-25.

C:1-52 "Fireman, Allowed; uniform" is discussed at ¶L-3806. Note: The CHECKPOINT source document does not use the gender neutral phrase "firefighter." The revenue ruling dealing with this topic is Rev. Rul. 70-474, 1970-2 C.B. 34. pp. C:1-27 and C:1-28.

C:1-53 a. 13.

b. 12 issues are listed in the findings of fact.

c. Yes. The Fourth Circuit reviewed the case. pp. C:1-28 and C:1-29.

C:1-54 a. 27.

b. No. According to the headnote to the opinion, the decision dealt with one issue, deductions.

c. No. The decision has not been cited unfavorably. pp. C:1-28 and C:1-29.

C:1-55 a. 1972.

b. The deductibility of the cost of a customer list under Sec. 162.

c. The government. The cost was not currently deductible.

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d. No. The decision was not reviewed at the trial level.
e. Yes. The decision was appealed to the Sixth Circuit Court of Appeals.
f. Yes. The CHECKPOINT citator lists nine citations to the Tax Court Memorandum decision and 13 citations to the CA6 decision. pp. C:1-26 through C:1-29.

C:1-56 a. To file a tax return electronically, one must (1) purchase the requisite software from a commercial vendor or download it from a designated Internet site; (2) obtain a Personal Identification Number (PIN) from the IRS; (3) either prepare a tax return offline and upload, or prepare the return online; and (4) transmit the return to the IRS.
b. The taxpayer can transmit funds electronically in one of three ways: (1) by authorizing an electronic funds withdrawal from a checking or savings account; (2) by authorizing payment by credit card; or (3) by mailing to the IRS a check or money order using a payment voucher.
c. Electronic filing (1) allows the taxpayer to file a return from any personal computer; (2) is more accurate than manual filing; (3) offers the safety and security of direct deposit; (4) offers the convenience of filing a tax return early and delaying payment up to the due date, and (5) allows one to file federal and state tax returns simultaneously. p. C:1-28.

C:1-57 a. "Request for Copy of Tax Return."
b. "Corporation Claim for Deduction for Consent Dividends."
c. "Excise Tax on Greenmail."
p. C:1-28.

C:1-58 a. "Request for Copy of Individual Tax Return."
b. "Corporation Income and Franchise Tax Return."
c. "Partnership Income Tax Return."
p. C:1-28.

C:1-59 The latest data as of this writing was for tax year 2022 (as of January 1, 2023)
a. 8 (Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, Wyoming).
b. 1 (New Hampshire).
c. 9.9%.
d. North Dakota, 2.9%.
p. C:1-28.

Comprehensive Problem

C:1-60 STEP ONE: In performing a keyword (intuitive) search in CHECKPOINT, type "depreciate garbage dump" and select the Federal Tax Coordinator Analysis. You will find the annotation ¶L-7922 Air space and pits used as dumps as depreciable property. This source cites *John Sexton* 42 TC 1094 (1964), where a taxpayer purchased an open-pit mine to be used as a dump. The Tax Court held for the taxpayer and allowed the depreciation.

The Tax Court reasoned that "rights in space have been recognized as property subject to transfer separately from the land" and concluded that these rights should be depreciable in the

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taxpayer's business. The Tax Court also held that the difference between the property's cost and salvage value was a reasonable measure of the amount to be depreciated and that a depreciation method based on the depreciable cost divided by quantity dumped was reasonable. The facts in *Sexton* are analogous to our client's case.

STEP TWO: Check the status of the case by checking the citator. The reasoning is followed in *Kendrick & Barbara Sanders*, 75 TC 157 (1980) and distinguished from *A, Duda & Sons v. U.S.*, 40 AFTR 2d 77-5911 (CA, 1977).

STEP THREE: Consult the AOD database to see if the IRS issued an Action on Decision for Sexton. In A.O.D. 1969 WL 21099, the IRS acquiesced in the result but disagreed with the Tax Court's reasoning. The IRS believed the depreciation should be premised on the land's having a determinable useful life rather than on the concept of air space separate from the land itself. The IRS, however, acquiesced without qualification to the taxpayer's units-of-production method of calculating depreciation.

STEP FOUR: Conclude that Mr. Stench can depreciate the difference between the dump's site's cost and salvage value at the end of its useful life ($20,000), and he should elect the units of production method to calculate the annual amount deductible. pp. C:1-26 through C:1-29.

Tax Strategy and Critical Thinking Problem

C:1-61 Choose Alternative 2; file the lawsuit in the Tax Court. HPU is likely to lose a lawsuit filed in the U. S. district court (Alternative 1) because that court is bound by *district court* precedent adverse to the taxpayer. Likewise, HPU is likely to lose a lawsuit filed in the Court of Federal Claims (Alternative 3) because that court is bound by *circuit court* precedent adverse to the taxpayer. On the other hand, in the Tax Court (Alternative 2) the tax return position taken by HPU has a realistic possibility of being sustained on its merits. In a case involving HPU, the Tax Court would not be bound by the other circuit court's precedent, which is adverse to the taxpayer because of the Golsen Rule. Rather, the Tax Court would be bound by HPU's own circuit court precedent, which, based on the specific facts of the problem, is nonexistent because HPU's circuit court has merely offered *dictum*, which is not binding. However, if the Tax Court issues a ruling consistent with the circuit court's second proposition, namely, that by opening the home improvement center, HPU is merely "improving customer access to its existing products," HPU will win the lawsuit, and its deduction will be sustained. pp. C:1-21 and C:1-23.

Case Study Problem

C:1-62 Statement on Standards for Tax Services (SSTS) No. 2 states that "a member may, in good faith, rely on information furnished, without verification, by the taxpayer or by third parties" (Par. 2.3.2). Thus, you may accept Mal's information at face value. His increase in AGI of over $30,000 may explain his increase in charitable contributions of approximately $10,000. In the second scenario the provision from SSTS No. 2 that a member "should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member" would be pertinent. Recently, the

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IRS audited Mal's return, and Mal lacked substantiation for about 75 percent of the charitable contributions he had claimed. (He may have made the contributions, but he could not prove that he did.) Further, the round amount ($25,000) reported by Mal suggests that Mal may be estimating what he contributed. You probably should request to see substantiation (canceled checks, etc.) for the contribution(s) claimed. For charitable contributions of $250 or greater, no deduction is allowed unless the donee organization substantiates the contribution with a contemporaneous, written acknowledgement. Mal needs to be made aware of this rule for his current year's return. All cash contributions, regardless of amount, must be documented with a bank record or written communication from the charity. The communication must include the name of the charity, date, and amount. p. C:1-32.

Tax Research Problems

C:1-63 a. The primary issue is whether the amounts Thomas A. Curtis, M.D. Inc. paid to Ellen Curtis as compensation during fiscal years 1988 and 1989 were reasonable.

b. Neither party was totally victorious. In fiscal year 1988, Ellen Curtis was paid $410,500. The amount held to be reasonable compensation by the Tax Court for 1988 was $227,000. In fiscal year 1989, Ellen Curtis was paid $510,500. The amount held to be reasonable compensation by the Tax Court for 1989 was $239,000. The amount held to be compensation, however, is more than the $100,000 and $105,000 the IRS asserted was reasonable compensation.

c. The plaintiff is the corporation because it is the party that claimed a deduction for the compensation. The IRS is attempting to disallow the corporation's deduction for part of the compensation paid. The disallowance of the deduction will have little effect on the two individuals since the amounts received will be either salary or dividends depending on the outcome of the case.

d. Ellen Barnert married Dr. Thomas Curtis in 1984.

e. Ms. Curtis worked approximately 60 to 70 hours supervising all departments set up within the corporation and the independent contractors, including scheduling and staffing of all the corporation's offices. Ms. Curtis was a registered nurse. She had a bachelor's degree in science and took worker's compensation courses at the University of Southern California Law School. She had worked as a nurse for a number of years and managed an ambulatory hospital system.

f. In fiscal year 1989, Ellen Curtis was paid $510,500. The Tax Court held $239,000 to be reasonable compensation in 1989.

g. The corporation paid no dividends in either fiscal year.

h. The case is appealable to the Ninth Circuit.

i. The five factors mentioned in determining reasonable compensation according to Elliott's are: (1) the employee's role in the company, (2) external comparison of the employee's salary with those paid by similar companies for similar services, (3) character and condition of the company, (4) conflict of interest in the employee's relationship to the corporation, and (5) the internal consistency in the company's treatment of payments to employees.

C:1-64 Judicial authority exists to exclude the Medicare payments from the amount the mother is treated as having provided for her own support. The IRS agrees with this authority; therefore, if the IRS audits the client's return, the IRS will not argue that Josh's mother provided the majority

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of her own support. (This information should be included in the client letter.)

The work papers should include a discussion of the authorities summarized below. Section 152(a) provides that one of the tests for claiming another as a dependent is to provide over one-half of such person's support. (Note: Josh's mother's gross income of $2,000 is not too high in the current year for her to be claimed his dependent assuming all other requirements are met.) If he provides over one-half of her support, he also may deduct any medical expenses he pays on her behalf. Section 152 does not define "support." Regulation Sec. 1.152-1(a)(2) states that support includes "food, shelter, clothing, medical and dental care, education, and the like." It also provides that in determining the amount an individual contributes to his own support, one must count the cost of support items paid for from "income, which is ordinarily excludable from gross income, such as benefits received under the Social Security Act."

In Alfred H. Turecamo v. CIR, 39 AFTR 2d 77-1487, 77-1 USTC ¶9415 (2nd Cir., 1977), the court held that hospital costs paid by Basic Medicare do not constitute support the ill person furnishes for himself or herself. After studying the legislative history of the Medicare statute, the court could find no valid basis "for distinguishing between hospital benefits received under Part A of Medicare [Basic Medicare] and either private insurance proceeds or supplemental benefits received under Part B [of Medicare]."

In Rev. Rul. 70-341, 1970-2 C.B. 31, the IRS ruled that Basic Medicare payments on a person's behalf must be treated as contributions by such person toward his own support. Such treatment was in contrast to that of Supplemental Medicare, which the IRS viewed as in the nature of insurance proceeds, and not self-support. Revenue Ruling 64-223, 1964-2 C.B. 50, held that amounts paid by an insurance company for medical costs are disregarded in the support test.

In Rev. Rul. 79-173, 1979-1 C.B. 86, however, the IRS revoked Rev. Rul. 70-341. Thus, the IRS currently treats Basic Medicare payments consistently with Supplemental Medicare and ignores amounts received from either source for purposes of the support test. In Archer v. Comm. 73 T.C. 963 (1980), the court held that both Medicare and Medicaid are disregarded in the support test.

C:1-65 In determining whether the property is used "too much" for personal purposes so that Sec. 280A applies, use of the residence by Amy or by family members constitutes personal use, as does use by persons who pay less than fair rental value (Sec. 280A(d)(2)). Use by Amy when performing repairs and maintenance full-time is totally disregarded (Sec. 280A(d)(2)). For purposes of allocating the expenses attributable to rental use, however, all the days on which the property is rented for fair rental value are considered, even if the property is rented to family members on some of these days (Prop. Reg. Sec. 1.280A-3(c)).

The total number of days rented at fair rental value – the numerator of the fraction used in the allocation – is determined as follows:

Days rented to sister	8
Days rented to cousin	4
Days rented to three families	120
Total	132

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The denominator for allocating interest and taxes is in dispute. Per Prop. Reg. Sec. 1.280A-3(d)(3), the denominator is the total number of days of actual use (exclusive of use by the owner for performing repairs). Thus, the denominator would be 146 (12 + 8 + 4 + 2 + 120). Case law supports using as the denominator the number of days in the year, or 365 days in this case for allocating interest and taxes. Dorrance D. Bolton v. CIR 51 AFTR 2d 83-305, 82-2 USTC ¶9,699, (9th Cir., 1982), affirming 77 T.C. 104 (1981), and Edith G. McKinney v. CIR 52 AFTR 2d 83-6281, 83-2 USTC ¶9,665 (10th Cir., 1983).

For allocating repairs, insurance, and depreciation, this ratio is the number of days rented at fair rental value divided by the total number of days of actual use, or 132/148. However, there is a conflict between Sec. 280A(e) and Prop. Reg. §1.280A-3(d)(3). The proposed regulation excludes repair days from the denominator, but the IRC is silent. Excluding the repair days results in a denominator of 146.

C:1-66 a. The principal issue in both cases was whether the corporation could deduct amounts paid as compensation to the spouse (ex-spouse) of a sole shareholder. This issue, in turn, depended on whether such compensation was "reasonable" under the circumstances.

b. The Tax Court considered a number of factors, including (1) the employee's qualifications and training, (2) the nature, extent, and scope of her duties, (3) responsibilities and hours involved, (4) the size and complexity of the business, (5) the results of the employee's efforts, (6) the prevailing rates for comparable employees in comparable businesses, (7) the scarcity of other qualified employees, (8) the ratio of compensation to the gross and net income of the business, (9) the salary policy of the employer to other employees, and (10) the amount of compensation paid to the employee in prior years.

c. The facts of these cases are similar in the following respect: in both cases, the taxpayers were corporations that claimed a deduction for payments made to the spouse or ex-spouse of a sole shareholder. The facts are different in these respects: (1) In Summit the IRS contended that only a portion of the salary payments were nondeductible; in J.B.S., it argued that none of the salary payments were deductible. (2) In Summit, the spouse performed extensive services for the firm; in J.B.S., the ex-spouse appears to have performed no services. (3) In Summit, the court took into consideration the corporation's rising profits; in J.B.S., the court did not. (In fact, the latter opinion does not mention the firm's profits or loss position). (4) In Summit, the payments did not appear to be motivated by tax avoidance. (Because the corporation paid substantial dividends to its sole shareholder, the payments to the spouse did not appear to be "disguised dividends"). In J.B.S., the payments did appear to be motivated by tax avoidance. (Testimony indicated that some tax positions had been taken to minimize the corporation's tax liability.)

C:1-67 The memorandum should supply the following answers:

a. Revenue Proc. 2024-1, 2024-1 I.R.B. 1 and Rev. Proc. 2024-4, 2024-1 I.R.B. 162 govern requests for determination letters.

b. Form 5300, "Application for Determination for Employee Benefit Plan," must be filed with the request.

c. The following information must be provided in the request:

1. Complete statement of facts and other information

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2. Copies of all contracts, wills, deeds, agreements, instruments, other documents pertinent to the transaction, and foreign laws
3. Analysis of material facts
4. Statement regarding whether same issue is in an earlier return and additional information required for §301.9100 requests
5. Statement regarding whether same or similar issue was previously ruled on or whether a request involving it was submitted or is currently pending
6. Statement regarding interpretation of a substantive provision of an income or estate tax treaty
7. Statement regarding involvement of a transactional party located in a foreign country
8. Letter from Bureau of Indian Affairs relating to a letter ruling request for recognition of Indian tribal government status or status as a political subdivision of an Indian tribal government.
9. Statement of supporting authorities
10. Statement of contrary authorities
11. Statement identifying pending legislation
12. Statement identifying information to be deleted from the public inspection copy of letter ruling or determination letter
13. Signature by taxpayer or authorized representative
14. Authorized representatives
15. Power of attorney and declaration of representative
16. Penalties of perjury statement
17. Number of copies of request to be submitted
18. Sample format for a letter ruling request
19. Checklist for letter ruling requests

d. Actions that must accompany the filing include payment of appropriate user fee and notification of interested parties.

"What Would You Do In This Situation?" Solution

Ch. C:1, p. C:1-34.

In this context, you have two professional duties: first, a duty of confidentiality to each client, and second, a duty to verify information that appears to be incorrect on its face. According to Statement No. 2 of the Statements on Standards for Tax Services, a member who is required to sign a tax return should consider information actually known to the CPA from the tax return of another client if (1) that information is relevant to the former return, (2) its consideration is necessary to properly prepare that return, and (3) the use of such information does not violate any rule of confidentiality. Here, (1) the information relating to each return is relevant to the other; (2) its consideration is necessary to properly prepare the other return; and (3) the use of such information does not violate any rule of confidentiality, *so long as the information is not disclosed to the other client.* Your considering the tax return information should lead you to believe that it is incorrect on its face; therefore, you have a duty to verify it.

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Accordingly, without revealing the basis for your belief, you should request from each client documentary evidence of its respective claim. Such evidence should consist of a paid invoice, a canceled check, a signed or certified receipt, a bill of lading, or any other document that indicates the essential terms of the contract of sale.

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Chapter C:1

Tax Research

Learning Objectives

After studying this chapter, the student should be able to:

1. Distinguish between closed fact and open fact tax situations.
2. Describe the steps in the tax research process.
3. Explain how the facts influence tax consequences.
4. Identify the sources of tax law and assess the authoritative value of each.
5. Consult tax services to research an issue.
6. Apply the basics of Internet-based tax research.
7. Use a citator to assess tax authorities.
8. Describe professional guidelines that CPAs in tax practice should follow.
9. Prepare work papers and communicate to clients.

Areas of Greater Significance

Since this will usually be a student's first exposure to tax research, the importance of the facts to the tax results, federal tax services and the citator should be discussed. The widespread use of Internet-based databases for tax research makes this means of tax research much more important. An effort should be made to introduce Internet-based searches to the students if at all possible. The text discusses two types of professional guidelines for CPAs in tax practice. It is also important to introduce the students to written communication of research outcomes, so it is suggested that the instructor spend time showing students Appendix A and discussing the importance of written communication.

Areas of Lesser Significance

In the interest of time, the following areas may be omitted:

Sample workpapers in Appendix A, but focus on the templates and importance of written communication.

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Problem Areas for Students

The following areas may prove especially difficult to students:

1. Understanding how to use the tax services and citators.

2. Learning the authoritative value of each source of tax law.

Highlights of Recent Tax Law Changes

1. For revenue rulings (and other IRS pronouncements) issued after 1999, the full four digits of the year of issuance are provided in the title. For revenue rulings and other pronouncements issued before 2000, only the last two digits of the year of issuance are provided in the title.

2. Students should become familiar with the use of Internet-based databases which have replaced the paper services.

3. For changes to the IRC enacted after July 29, 1996, the Treasury is generally precluded from issuing regulations with retroactive effect. In the case of final regulations, however, a regulation can be effective on the date proposed or the date on which temporary regulations are filed with the Federal Register. Regulations issued within 18 months of the date of a change to the statute can be issued with retroactive effect.

4. Both CCH and RIA provide tax-related information via the Internet. The United States Tax Reporter is also available on LexisNexis and Westlaw.

Teaching Tips

1. Example C:1-2: Use the example to emphasize to the students the importance of considering nontax objectives as well as tax objectives. p. C:1-2.

2. Steps in the Tax Research Process, Paragraph 1: Walk through the steps in the tax research process. As you do this, emphasize to the students that the steps of the tax research process provide an excellent format for a written communication to a client or for a client file. You might consider going over the client communication contained in Appendix A.

3. If proper citations are being stressed in the course, Table C:1-3 is a good reference.

4. Illustrate to the students how to use the Internet version of one of the tax services or the LEXIS online service in an in-class demonstration.

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Lecture Outline

I. Overview of Tax Research.

Tax research can be conducted in a number of different settings. Tax research involves solving a specific tax-related question using a number of tax law sources as they apply to a particular situation. Sample work papers demonstrating how to document the results of a research effort are included in Appendix A. In addition, the text discusses two types of professional guidelines for CPAs in tax practice: the AICPA's guidelines for CPAs in tax practice, the Statements on Standards for Tax Services and Treasury Department Circular 230 (these standards are referenced in Appendix E, with links to them provided).

A. Client-oriented research is conducted by accounting and law firms for the benefit of their clients. It involves determining the tax consequences of a certain transaction for a given client. It is performed in:

1. Closed-fact or tax compliance situations. (See Example C:1-1.) p. C:1-2.
2. Open-fact or tax-planning situations. (See Example C:1-2.) p. C:1-2.

B. **Academic settings.** Tax policy research may be conducted by individuals in an academic setting (e.g., accounting programs, law schools, economics departments, etc.).

The tax advisor should always bear in mind the financial accounting implications of proposed transactions. Though interrelated, the two fields of accounting have different orientations and different objectives. Tax accounting is oriented primarily to the Internal Revenue Service. Its objectives include calculating, reporting, and predicting one's tax liability according to legal principles. Financial accounting is oriented primarily to shareholders, creditors, managers, and employees. Its objectives include determining, reporting, and predicting a business's financial position and operating results according to Generally Accepted Accounting Principles.

II. Steps in the Tax Research Process.

When doing tax research in the context of tax planning or just in engaging in tax planning, the emphasis should be placed on the circular nature of the tax research process. It often requires the determination of different facts, restatement of the research question, or reliance on additional authorities. (Refer here to Figure C:1-1) p. C:1-4. There are, however, six basic steps to the tax research process:

1. Determine the facts.

2. Identify the issues (questions).

3. Locate the applicable authorities.

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4. Evaluate the authorities and choose those to follow where the authorities conflict.

5. Analyze the facts in terms of the applicable authorities.

6. Communicate conclusions and recommendations to the client.

A professional needs to keep a number of points in mind.

A. The objective is not to minimize taxes per se but rather to maximize the after-tax return.

B. One does not engage in unilateral transactions; thus, the tax ramifications to all parties to the contract are relevant.

C. Taxes are but one cost of doing business.

D. The time for tax planning is not restricted to when one enters into an investment, contract, or other arrangement, but rather the time extends throughout the life of the activity.

Appendix A walks students through the research process.

Tax research often involves a "gray area;" that is, one that does not have a clear-cut, unequivocally correct solution. The issue should be pursued through the use of a specifically tailored set of detailed questions. Tax research may also involve determining which issues need to be researched. It requires a fairly extensive knowledge of tax law to be able to determine which issues need to be researched.

A tax advisor should always bear in mind the financial accounting implications of proposed transactions. An answer that may be desirable from a tax perspective may not always be desirable from a financial accounting perspective. Success in any tax practice, especially at the managerial level, requires consideration of both sets of objectives and orientations.

III. Importance of the Facts to the Tax Consequences.

The importance of a particular set of facts to the tax results should be emphasized. Three illustrations are presented for class discussion. These illustrations should naturally lead into a discussion of how a factual situation can be designed to meet the statutory requirements.

IV. The Sources of Tax Law.

The term "tax law" generally encompasses much more than just the tax statutes as enacted by Congress. The law contains very general language that requires interpretation, both administrative and judicial. Administrative interpretations include Treasury Regulations, revenue

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rulings, and revenue procedures. Judicial interpretations consist of court decisions. Tax law also consists of committee reports issued by Congress during the legislative process.

A. **Legislative Process.** All tax legislation must originate in the House of Representatives. Tax bills are referred to the House Ways and Means Committee. After a bill is approved by the House Ways and Means Committee, it moves to the floor of the House for consideration. If approved by a majority of the House, it moves to the Senate. After consideration by the Senate Finance Committee, it moves to the Senate floor for approval. Usually the House and Senate bills will not be in complete agreement. The bill will then go to a conference committee consisting of members of both houses. A compromise will then be made between the two versions of the tax bill. The compromise is then voted on by both houses of Congress and goes on to the President for his signature or veto. Both houses of Congress generally hold extensive hearings at which time interested parties are free to testify. The U.S. Government Printing Office publishes the statements made at hearings. Committee reports explaining Congress's purpose in drafting legislation are published by the U.S. Government Printing Office in the **Cumulative Bulletin**. Committee reports are particularly useful in interpreting the law prior to issuance of Treasury regulations. (See Example C:1-4.) p. C:1-8.

B. **Internal Revenue Code.** The Internal Revenue Code is the foundation of all tax law. It was first codified in 1939. Recodified in 1954, it has now been named the Internal Revenue Code of 1986. Whenever the law is changed, old language is deleted and new language is added.

C. **Treasury Regulations.** The Treasury Department issues Treasury Regulations as interpretations of the statute. They provide examples complete with computations to assist in understanding how IRC provisions are applied. Because statutory changes occur frequently, regulations are not always updated in a timely manner. When referring to a regulation, the tax advisor should consult the introductory note in order to determine when the regulation was adopted. Treasury Regulations are first provided in proposed form and the public has an opportunity to comment and suggest changes. Proposed regulations have no more authoritative weight than the position the IRS argues for in a brief, but provide guidance on the Treasury
Department's interpretation of a statute. Temporary regulations (which generally are effective upon publication) are often issued soon after a major statutory change to provide guidance on procedural and computational matters. Temporary regulations have the same authoritative value as final regulations; however, they cannot remain temporary for more than a three-year period. Temporary regulations must be issued concurrently with proposed regulations. Final regulations are drafted after the public has had time to comment on the proposed regulations. Final regulations have the same authoritative weight as the statute and generally take effect retroactive to the effective date of the statutory language they interpret.

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For changes to the IRC enacted after July 29, 1996, the Treasury is generally precluded from issuing regulations with retroactive effect. In the case of final regulations, however, a regulation can be effective on the date proposed or the date on which temporary regulations are filed with the Federal Register. Regulations issued within 18 months of the date of a change to the statute can be issued with retroactive effect.

Regulations may also be classified as either interpretative or legislative. Interpretative regulations are issued under the general authority of Sec. 7805 and make the statutory language easier to understand and apply. They provide illustrations about how to perform certain computations. Legislative regulations provide rules on highly technical matters where Congress has delegated the rulemaking to the Treasury Department (e.g., consolidated tax return issues). Both types of regulations have the same authoritative weight and will be overturned only in very limited cases such as when, in the Court's opinion, the regulations exceed the scope of power delegated to the Treasury Department, are contrary to the IRC, or are unreasonable.

Section 7805 provides that the Secretary of the Treasury has the right to prescribe regulations and to provide what extent they are to be applied retroactively. Occasionally, taxpayers can successfully argue that a regulation is invalid and, consequently, should not be followed. This will occur only if the courts find that the regulation is "unreasonable and plainly inconsistent with the revenue statutes." Some courts apply the **legislative reenactment doctrine**, which holds that regulations finalized many years earlier and not amended by Congress through changes to the statutory language have Congressional approval.

Regulations are cited as follows. Numbers before the decimal point indicate the general subject matter of the regulation. Numbers to the right of the decimal place refer to the IRC section being interpreted. Numbers to the right of that number indicate the number of the regulation. Temporary or proposed regulations are cited as Temp. Reg. Sec. or Prop. Reg. Sec. When providing a citation, the researcher should be as precise as possible. An example of this would be Reg. Sec. 1.165-5(I), Ex. 2(I), which refers to the first portion of Example 2 that is contained in the first portion of the fifth regulation interpreting Sec. 165. You may wish at this point to use the **Stop and Think** material, which illustrates the force of law certain regulations have. pp. C:1-10-C:1-11.

D. **Administrative Pronouncements.** There are a number of different means that the IRS uses for interpreting the statute. After referring to the IRC and Treasury Regulations, tax advisors are likely to refer next to IRS interpretations for further authority for answering a tax question.

1. **Revenue Rulings.** Revenue rulings are used to indicate the tax status of a specific transaction, which has wide taxpayer interest. They represent the viewpoint of the IRS and do not have as much authority as federal court cases or regulations. Approximately two dozen rulings were issued

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each year in 2022 and 2023. A taxpayer does not have to follow a ruling if there is sufficient authority for different treatment. An IRS agent is, however, bound by the rulings. Rulings are published weekly in the **Internal Revenue Bulletin** (I.R.B.) and semiannually in the **Cumulative Bulletin** (C.B.) prior to 2009. Refer now to p. C:1-12 to see how revenue rulings are cited.

2. **Revenue Procedures.** Revenue procedures usually deal with procedural aspects of tax practice. They are first published in the **Internal Revenue Bulletin** and later in the **Cumulative Bulletin** until 2009. Refer now to p. C:1-12 to illustrate how revenue procedures are cited. In addition to revenue rulings and revenue procedures, the *Cumulative Bulletin* contains IRS notices, as well as the texts of proposed regulations, tax treaties, committee reports, and U.S. Supreme Court decisions. For revenue rulings issued after 2008, the Internal Revenue Bulletin is the final reference.

3. **Letter Rulings.** Letter rulings are initiated by taxpayers who ask the IRS to explain the tax consequences of a particular transaction. The IRS responds in a letter ruling that can be relied on only by the person requesting it. They provide insight into the current thinking of the IRS. CCH publishes rulings with any confidential information deleted in a separate letter ruling service. Refer to pp. C:1-12-C:1-13 to illustrate how letter rulings are cited.

4. **Technical Advice Memoranda.** When a taxpayer's return is being audited with respect to a complicated, technical matter, the taxpayer may request that the matter be referred to the IRS National Office in Washington, D.C. concerning the appropriate tax treatment. The answer is issued in the form of a Technical Advice Memoranda, which is made available in the form of a letter ruling. Refer to p. C:1-13 to illustrate how technical advice memoranda are cited.

5. **Tax Information Releases.** Tax Information releases contain information about interpretations of general interest and are released to the news media throughout the United States. Refer now to p. C:1-13 to illustrate how information releases are cited.

6. **Announcements and Notices.** Information releases that are more technical and aimed at tax practitioners are issued in the form of Announcements. Announcements are often issued before temporary or proposed regulations can be issued. The IRS is bound by announcements and notices in the same way as if contained in a revenue ruling. Notices and announcements issued prior to 2009 appear in both the Internal Revenue Bulletin and the Cumulative Bulletin. As of 2009, they appear only in the Internal Revenue Bulletin. Refer now to p. C:1-13 to illustrate how announcements are cited.

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E. **Judicial Decisions.** Judicial decisions comprise an important source of tax law. Judicial decisions in different jurisdictions are sometimes in conflict. See Figure C:1-1, p. C:1-15 for a summary of the court system.

Overview of the Court System. There are three trial courts - the U.S. Tax Court, the U.S. Court of Federal Claims, and the U.S. District Courts. Litigation may begin in any court, but precedent is an important factor in determining where it should begin. Cash flow also may be an important factor. Taxes must be paid before litigation begins in the U.S. Court of Federal Claims or the U.S. District Courts. After the taxes are paid, a claim for refund is filed, which will be denied by the IRS. A suit for refund is then brought and, if won, a refund with interest is obtained. A suit may be brought in the Tax Court. If lost, the deficiency plus any interest and penalties must be paid. The District Courts are the only place that a jury trial is possible. Decisions can be appealed from the Tax Court and the U.S. District Courts to the Court of Appeals in the taxpayer's circuit. Appeals from the U.S. Court of Federal Claims are taken to the Court of Appeals for the Federal Circuit. A party who loses at the appellate level can ask the Supreme Court for a **writ of certiorari**. The Supreme Court hears only about six to ten tax cases a year. (See Table C:1-1 Federal Judicial Circuits for a listing of states in the various Courts of Appeals on p. C:1-15.) (See Table C:1-2 for an overview of the court system on p. C:1-16.)

U.S. Tax Court. The U.S. Tax Court originated in 1942 as the successor to the Board of Tax Appeals. It is a court of national jurisdiction that hears only tax-related cases. All taxpayers, regardless of their state of residence, may litigate in the Tax Court. It has 19 judges, including one chief judge. The President, with the consent of the Senate, appoints the judges for a 15-year term and may reappoint them for an additional term. The judges, specialists in tax-related matters, periodically travel to roughly one hundred cities throughout the country to hear cases. In most instances, only one judge hears a case.

The Tax Court has a special policy in dealing with cases where the amount in question does not exceed $50,000 a year (i.e., small cases). Taxpayers can represent themselves without an attorney. The cases are heard by special commissioners instead of one of the Tax Court judges. Decisions under this procedure cannot be appealed.

The IRS has an **acquiescence policy** with regard to federal court decisions that have been decided in the taxpayer's favor. If it wishes to go on record that it agrees with a federal court decision, it acquiesces. If it wishes to disagree with a decision, it issues a nonacquiescence. This policy is not followed in all federal court decisions. An acquiescence or nonacquiescence is binding on an IRS agent. If a taxpayer is audited and has taken a position, in which the IRS has issued a nonacquiescence, litigation will likely be the only recourse for the taxpayer. IRS acquiescences and nonacquiescences are published in the Internal Revenue Bulletins and Cumulative Bulletins.

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Regular decisions of the Tax Court are published by the U.S. Government Printing Office in a bound volume known as the **Tax Court of the United States Reports**. Soon after a decision is made public, it is also published by RIA and CCH in their loose-leaf reporters of Tax Court decisions. Refer now to Table C:1-3, p. C:1-22 to illustrate regular and memo Tax Court citations.

U.S. District Courts. Each state has a U.S. district court and more populous states have several district courts. Many different types of cases are heard by this court and a taxpayer may request a jury trial. District court decisions are officially reported in the **Federal Supplement** (F. Supp.) published by West. Tax decisions are also published by RIA in the **American Federal Tax Reports** (AFTR) and by CCH in the **U.S. Tax Cases** (USTC). Refer now to Table C:1-3, p. C:1-22 to illustrate a district court citation.

U.S. Court of Federal Claims. The U.S. Court of Federal Claims, as reorganized in 1982 and renamed in 1992, is a national court with decisions appealable to the Circuit Court of Appeals for the Federal Circuit. U.S. Court of Federal Claims decisions were published in the **Claims Court Reporter** by West Publishing Co. from 1982 to 1992. These cases are now reported in the **Federal Claims Reporter** (Fed. Cl.). In addition, the AFTR and USTC services report these tax decisions. Refer now to Table C:1-3, p. C:1-22 to illustrate this citation.

Circuit Courts of Appeal. Trial court decisions are appealable to a particular circuit court of appeals depending upon where the litigation originated. In the case of an individual, it depends upon the taxpayer's residence on the date of appeal. In the case of a corporation, it is the principal place of business that controls. There are 11 geographical circuits, the circuit for the District of Columbia and the Federal Circuit. (See Figure C:1-3, p. C:1-22.) New circuit court of appeals decisions are reported officially in the **Federal Reporter, Third Series** (F.3d) published by West. In addition, AFTR and USTC services report these decisions. Refer now to Table C:1-3, p. C:1-22 to illustrate this citation.

Supreme Court. A decision of an appellate court can be appealed to the U.S. Supreme Court. Unless the circuits are divided on the proper treatment of an issue or the issue is deemed of great significance, the Supreme Court will not grant **certiorari**. Decisions of the Supreme Court are the law of the land. If Congress does not agree with a Supreme Court decision, statutory language can be amended to reach the desired result. Supreme Court decisions are published in the **United States Supreme Court Reports** (U.S.) by the U.S. Government Printing Office, the **Supreme Court Reporter** (S.Ct.) by West, and the **United States Reports, Lawyers' Edition** (L.Ed.) by Lawyer's Co-Operative Publishing Co. In addition, the AFTR and USTC services report these tax decisions. Refer now to Table C:1-3, p. C:1-22 to illustrate this citation.

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Precedential Value of Various Decisions.

1. The Tax Court will generally rule uniformly for taxpayers. It is bound by Supreme Court decisions. In 1970, the **Golsen** rule was adopted which mandates that the Tax Court will follow decisions of the court for the circuit to which a case in question is appealable.

2. U.S. district court decisions have precedential value only for subsequent cases heard in the same district. District courts must follow decisions of the Supreme Court and the court of appeals to which the case is appealable.

3. The U.S. Court of Federal Claims must rule consistently with the Supreme Court, Circuit Court of Appeals for the Federal Circuit, and its own earlier decisions.

4. A circuit court of appeals is bound by the Supreme Court and earlier decisions made by that circuit. *Green v.* US 185 F. 3d 67, 84 AFTR 2d 99-5415, 99-2 USTC ¶50,701 (3rd Cir, 1999).

   The Green Case appears on page 67, volume 185 of the *Federal Reporter, Third Series.* It is also published in volume 84, page 99-5415 on AFTR, Second Series, and in Volume 2, Paragraph 50,701 of the 199 USTC. The parenthetical information indicates that the Third Circuit decided the case in 1999 (*The Federal Reporter, Second Series* reference is found in footnote 33 of this chapter).

Because the courts are not always in agreement, a taxpayer can sometimes **forum shop** to select a court that is likely to be most favorable to the taxpayer's position. You may wish to use the **Stop and Think** materials at this point, which illustrate the importance of forum shopping. p. C:1-24.

F. **Tax Treaties.** The United States has treaties with a number of foreign countries. The treaties may pertain to tax and other matters. The provisions contained in a treaty in most cases override the rules contained in the IRC. p. C:1-24.

G. **Tax Periodicals.** Writings of tax experts in tax periodicals can provide useful insight into provisions contained in the IRC, Regulations, cases, or rulings. A list of periodicals is found on p. C:1-24. Published articles and tax service commentaries are secondary sources of authority. Primary sources of authority are the IRC and administrative and judicial interpretations. Only primary authorities should be cited.

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V. Tax Services.

Organizationally, there are two types of tax services: first, "annotated," and second, "topical." An annotated tax service is organized by IRC section. The IRC-arranged subdivisions of this service are likely to encompass several topics. A topical tax service is organized by broad topic. The topically arranged subdivisions of this service are likely to encompass several IRC sections. The principal annotated tax services are United States Tax Reporter and Standard Federal Tax Reporter. The main topical services are Federal Tax Coordinator 2d and Tax Management Portfolios.

VI. The Internet as a Research Tool.

Internet databases are rapidly replacing books as the principal source of tax-related information. These databases encompass not only the IRC, Treasury Regulations, court cases, state laws, and other primary authorities, but also citators and secondary sources such as tax service reporters, treatises, journals, and newsletters. The principal advantages of using Internet-based tax services are ease and speed of access. The databases can be accessed using annotations or a "key word" approach. The annotated versions are arranged by IRC section. The annotations accompany editorial commentaries and include digests and summaries of IRS pronouncements and court opinions that interpret a particular IRC section. A topical tax service is organized by broad topic, including income taxes, estate and gift taxes, and excise taxes. The topically arranged sub-divisions of this service are likely to encompass several IRC sections. Each database is updated on a timely basis. See Table C:1-4 on p. C:1-25 for a summary of the key features of tax services.

Most institutions utilize the CCH AnswerConnect product.

VII. Citators.

Citators serve two functions: (1) they provide a history of the case; and (2) they list other authorities that have cited the case. The citator allows the user to input the names of specific case citations, and see all related pronouncements and status changes.

VIII. Professional Guidelines for Tax Services.

Professional guidelines for tax services are contained in both government-imposed and professional-imposed tax standards. Circular 230 sets forth rules to practice before the Internal Revenue Service and pertains to certified public accountants, attorneys, enrolled agents, and other persons representing taxpayers before the IRS. It presents duties and restrictions relating to such practice and prescribes sanctions and disciplinary proceedings for violating these regulations. Circular 230 also provides guidelines for written advice to taxpayers. In June 2014, these guidelines were significantly revised and eliminated the distinction between covered opinions and written advice. All rules are now governed under what is referred to as a "reasonable practitioner standard." In the case of written

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advice, the practitioner is now supposed to base advice under reasonable assumptions and consider the facts that are important and not base an opinion on the probability of audit.

Statements on Standards for Tax Services (SSTS), issued by the American Institute of Certified Public Accountants and referenced in Appendix E, set forth guidelines governing ethical issues in tax practice. Although the SSTSs are not legally enforceable, they carry significant moral weight, and may be cited in a negligence lawsuit as the proper "standard of care" for tax practitioners. They also provide grounds for the termination or suspension of one's professional license. The Standards provide an ethical framework to govern the normative relationship between a tax advisor and his or her client, where, unlike an auditor, a tax advisor acts as the client's advocate.

Instructors also may wish to reference how Cornell University offers free access to many resources. This should be emphasized to students, specifically if they do not have college library access to the professional databases referenced within the chapter.

IX. Sample Work Papers.

Appendix A presents a set of sample work papers, including a draft of a client letter and a memo to the file. The work papers indicate the issues to be researched, the authorities addressing the issues, and the researcher's conclusions concerning the appropriate tax treatment, with rationale for its use. Formats differ from firm to firm. The sample offers general guidance concerning the content of work papers.

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Court Case Briefs

The following court cases illustrate how the courts, through judicially enunciated doctrines, impact the interpretation of tax law.

Hirotoshi Yamamoto* v. *CIR, 73 T.C. 946 (1980), aff'd. in unpublished opinion 672 F.2d 924 (9th Cir., 1982).

Yamamoto (Y) owned 100% of the stock of P Corporation. P Corporation owned 100% of the stock of subsidiary S. S was heavily indebted to P. During 1970 and 1971, S made loans to Y. Y transferred real property to S, those transactions being recorded as sales, in exchange for cash, release of Y's indebtedness to S and assumption of Y's liabilities by S. Subsequently, S transferred this property to P at a price equal to S's book value in the property. Additionally, Y purchased stock of P in exchange for cash.

Y argued that the step-transaction theory should apply to these transactions so they should be collapsed into one transaction and qualify for tax-free treatment under IRC Sec. 351. The court rejected this argument, stating that the rules for transfers to a controlled corporation did not apply because the property transfers and stock transfer had separate legal significance. The facts were consistent with this decision. This case involves a detailed analysis of the substance over form issue.

Evelyn F. Gregory* v. *Helvering, 293 U.S. 465 (1935).

Mrs. Gregory owned all of the stock of a corporation, which owned 1,000 shares of stock of another corporation. To get these shares and to obtain more favorable tax treatment, a new corporation was organized and the 1,000 shares of stock were transferred to it by the old corporation in what was claimed to be a nontaxable reorganization. The new corporation then dissolved and distributed its only asset, the shares of stock, to its sole shareholder, Mrs. Gregory. Mrs. Gregory then sold the stock and reported capital gains tax treatment on the sale. The Supreme Court held that a nontaxable reorganization had not occurred since the new corporation had no relation to the business of the old corporation and was formed solely as part of a preconceived plan with no business purpose. Tax avoidance was held not to be a sufficient business purpose to permit a tax-free reorganization to occur.

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