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Chapter C:1

Tax Research

Note: To do 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 Statements on Standards for Tax Services, the tax practitioner owes the client the following duties: (1) to inform the client of (a) the potential adverse consequences of a tax return position, (b) how the client can avoid a penalty through disclosure, (c) errors in a previously filed tax return, and (d) corrective measures to be taken; (2) to inquire of the client (a) when the client must satisfy conditions to take a deduction and (b) when information provided by him or her appears incorrect, incomplete, or inconsistent on its face; and (3) not to disclose tax-related errors without the client's consent. 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 advisers 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 over 55 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 CPA 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 (1) to verify client provided information if the information is not suspicious on its face and (2) to 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 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 January 2022.
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 Statements on Standards for Tax Services (SSTS) No. 3 states that a CPA "may in good faith rely, without verification, on information furnished by the taxpayer or by third parties" (Para. 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. 3 that a CPA "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 IRS audited Mal's return, and Mal lacked substantiation for about 75 percent of the charitable contributions he had

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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 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

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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

The denominator for allocating interest and taxes is in dispute. Per Prop. Reg. Sec. 1.280 A-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,

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(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. 2023-1, 2023-1 I.R.B. 1 and Rev. Proc. 2023-4, 2023-1 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
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

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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. 3 of the Statements on Standards for Tax Services, a CPA 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.

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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