South-Western Federal Taxation 2020 Corporations Partnerships Estates and Trusts 43rd edition Raabe Solutions Manual

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CHAPTER 1

UNDERSTANDING AND WORKING WITH THE FEDERAL TAX LAW

SOLUTIONS TO PROBLEM MATERIALS

DISCUSSION QUESTIONS

1. (LO 1) When enacting tax legislation, Congress often is guided by the concept of revenue neutrality so that any changes neither increase nor decrease the net revenues raised under the prior rules. Revenue neutrality does not mean that any one taxpayer's tax liability remains the same. Since this liability depends on the circumstances involved, one taxpayer's increased tax liability could be another's tax saving. Revenue-neutral tax reform does not reduce deficits, but at least it does not aggravate the problem.

2. (LO 2) Economic, social, equity, and political factors play a significant role in the formulation of tax laws. Furthermore, the IRS and the courts have had impacts on the evolution of tax laws. For example, control of the economy has been an important economic consideration in passing a number of laws (e.g., rapid depreciation, changes in tax rates). But, ultimately the tax law is written by Congress.

3. (LO 2) The tax law encourages technological progress by allowing immediate (or accelerated) deductions and tax credits for research and development expenditures.

4. (LO 2) Saving leads to capital formation and thus makes funds available to finance home construction and industrial expansion. For example, the tax laws provide incentives to encourage savings by giving private retirement plans preferential treatment.

5. (LO 2)
   a. Section 1244 allows ordinary loss treatment on the worthlessness of small business corporation stock. Since such stock normally would be a capital asset, the operation of § 1244 converts a less desirable capital loss into a more attractive ordinary loss. Such tax treatment was designed to aid small businesses in raising needed capital through the issuance of stock.

   b. The S corporation election allows the profits (or losses) of the corporation to flow through to its individual shareholders (avoiding the corporate income tax). In addition, the qualified business income deduction may apply to any flow-through profits (allowing a maximum 20% deduction to the shareholders). However, with the corporate tax rate being 21% (and individual marginal tax rates potentially being higher), individuals will need to compare the benefits of avoiding the corporate tax rate with the taxes on any S corporation flow-through profits.

6. (LO 2) Reasonable persons can, and often do, disagree about what is fair or unfair. In the tax area, moreover, equity is generally tied to a particular taxpayer's personal situation. For example, one equity difference relates to how a business is organized (i.e., partnership versus corporation). Two businesses may be equal in size, similarly situated, and competitors in the production of goods or services, but they may not be comparably treated under the tax law if one is a partnership and the other is a corporation. The corporation is subject to a separate Federal income tax of 21%; the partnership is not. The tax law can and does make a distinction between these business forms. Equity,

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then, is not what appears fair or unfair to any one taxpayer or group of taxpayers. Equity is, instead, what the tax law recognizes.

7. (LO 2) This deduction can be explained by social considerations. The deduction shifts some of the financial and administrative burden of socially desirable programs from the public (the government) sector to the private (the citizens) sector.

8. (LO 2) Preferential treatment of private retirement plans encourages saving. Not only are contributions to Keogh (H.R. 10) plans and certain Individual Retirement Accounts (IRA) deductible, but income from these contributions accumulates on a tax-free basis.

9. (LO 2) The availability of percentage depletion on the extraction and sale of oil and gas and specified mineral deposits and a write-off (rather than capitalization) of certain exploration costs encourage the development of natural resources.

10. (LO 2) Favorable treatment of corporate reorganizations provides an economic benefit. By allowing corporations to combine and split without adverse consequences, corporations are in a position to reduce their taxes and possibly more effectively compete with other businesses (both nationally and internationally).

11. (LO 2) Although the major objective of the Federal tax law is the raising of revenue, other considerations explain many provisions. In particular, economic, social, equity, and political factors play a significant role. Added to these factors is the impact the Treasury Department, the Internal Revenue Service, and the courts have had and will continue to have on the evolution of Federal tax law.

12. (LO 2) The deduction allowed for Federal income tax purposes for state and local income taxes is not designed to neutralize the effect of multiple taxation on the same income. At most, this deduction provides only partial relief. The $10,000 overall limitation on state and local taxes also reduces the tax benefit of these taxes. Only allowing a full tax credit would achieve complete neutrality.

    a. With the standard deduction, a taxpayer is, *indirectly*, obtaining the benefit of a deduction for any state or local income taxes he or she may have paid. The standard deduction is in lieu of itemized deductions, which include any allowed deductions for state and local income taxes.

    b. If the taxpayer is in the 10% tax bracket, $1 of a deduction for state or local taxes would save $0.10 of Federal income tax liability. In the 32% tax bracket, the saving becomes $0.32. The deduction approach (as opposed to the allowance of a credit) favors high-bracket taxpayers.

13. (LO 2) Under the general rule, a transfer of a partnership's assets to a new corporation could result in a taxable gain. However, if certain conditions are met, § 351 postpones the recognition of any gain (or loss) on the transfer of property by Heather to a controlled corporation.

    The wherewithal to pay concept recognizes the inequity of taxing a transaction when Heather lacks the means with which to pay any tax. Besides, Heather's economic position would not change significantly should the transfer occur. Heather owned the assets before the transfer and still would own the assets after a transfer to a controlled corporation.

14. (LO 2) Yes, once incorporated, the business may be subject to the Federal corporate income tax. However, the 21% corporate tax rate *might* be lower than Heather's individual tax rates, especially if dividends are not paid to Heather.

    The corporate income tax could be avoided altogether by electing to be an S corporation. An S corporation is generally not taxed at the corporate level; instead, the income flows through the corporate veil and is taxed at the shareholder level. An S election allows a business to operate as a corporation but be taxed like a partnership. With a partnership, there is no double tax. Income and expenses flow through to the partners and are taxed at the partner level.

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15. (LO 2) Examples include like-kind exchanges, involuntary conversions, transfers of property to a controlled corporation, transfers of property to a partnership, and tax-free reorganization.

16. (LO 2) Generally, a recognized (taxable) gain cannot exceed the realized gain.

17. (LO 2) Recognition of gain ultimately occurs when the property is disposed of.

18. (LO 2) One year.

19. (LO 2) The installment method on the sale of property permits the gain to be recognized over the payout period.

20. (LO 2) Requiring a taxpayer to make a contribution to a Keogh retirement plan by the end of the year would force an accurate determination of net self-employment income long before the income tax return must be prepared and filed.

21. (LO 2) The difference between common law and community property systems centers around the property rights possessed by married persons. In a common law system, each spouse owns whatever he or she earns. Under a community property system, one-half of the earnings of each spouse is considered owned by the other spouse. Assume, for example, that Harold and Ruth are husband and wife and that their only income is the $90,000 annual salary Harold receives. If they live in New York (a common law state), the $90,000 salary belongs to Harold. If, however, they live in Texas (a community property state), the $90,000 salary is divided equally, in terms of ownership, between Harold and Ruth.

22. (LO 2) Deterrence provisions include the following:

- Alternative minimum tax.
- Imputed interest rules.
- Limitation on the deductibility of interest on investment indebtedness.
- Gift and estate tax.
- Unreasonable accumulated earnings tax.
- Personal holding company tax.

23. (LO 4) Primarily concerned with business readjustments, the continuity of interest concept permits tax-free treatment only if the taxpayer retains a substantial continuing interest in the property transferred to the new business. Due to the continuing interest retained, the transfer should not have tax consequences because the position of the taxpayer has not changed. This concept applies to transfers to controlled corporations (Chapter 4), corporate reorganizations (Chapter 7), and transfers to partnerships (Chapter 10).

24. (LO 3) Under § 482, the IRS has the authority to allocate income and deductions among businesses owned or controlled by the same interests when the allocation is necessary to prevent the evasion of taxes or to clearly reflect the income of each business. Pursuant to § 482, therefore, the IRS might allocate interest income to White Corporation even though none was provided for in the loan agreement.

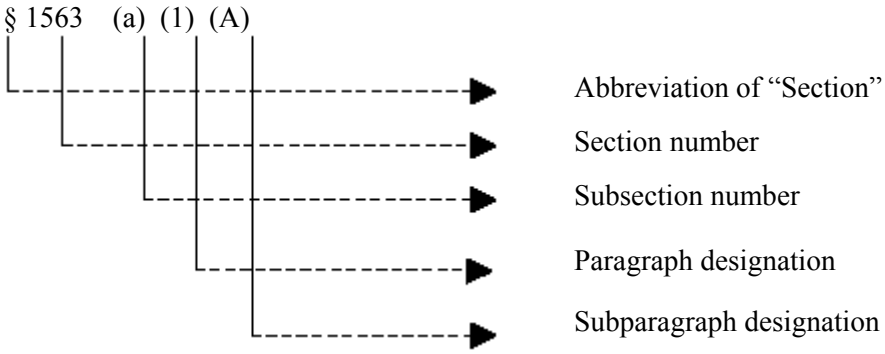
25. (LO 5) False. Federal tax legislation generally originates in the House of Representatives, where it is first considered by the House Ways and Means Committee. Only rarely does Federal tax legislation originate in the Senate. The Tax Equity and Fiscal Responsibility Act of 1982 originated in the Senate; its constitutionality was upheld by the courts.

26. (LO 5) A President's veto can be overridden by a two-thirds vote in both the House and Senate.

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27. (LO 5)



28. (LO 5) Yes. Some Code Sections omit the subsection designation and use, instead, the paragraph designation as the first subpart [e.g., §§ 212(1) and 1221(1)].

29. (LO 5) When the 1954 Code was drafted, the omission of some Code section numbers was intentional. This omission provided flexibility to incorporate later changes into the Code without disrupting its organization. This technique is retained in the 1986 code.

30. (LO 6) Proposed, final, and Temporary Regulations are published in the *Federal Register* (**federalregister.gov**) and are reproduced in major tax services. Final Regulations are issued as Treasury Decisions (TDs).

31. (LO 6)

a. A Temporary Regulation, with 1 referring to the type of regulation (i.e., income tax), 707 is the related code section number, 5 is the subsection number, T means temporary, (a) is the paragraph designation, and (2) is the subparagraph designation.

b. Revenue Ruling number 11, appearing on page 174 of Volume 1 of the *Cumulative Bulletin* issued in 1960.

c. Technical Advice Memorandum number 3 issued during the 37th week of 1988.

32. (LO 5)

Raabe, Young, Hoffman, Nellen, & Maloney, CPAs
5191 Natorp Boulevard
Mason, OH 45040

October 18, 2019

Ms. Jennifer Olde
3246 Highland Drive
Clifton, VA 20124

Dear Ms. Olde:

In response to your recent request, the fact-finding determination of a lower trial court is binding on a Federal Court of Appeals. A Federal Court of Appeals is limited to a review of the record of trial compiled by a trial court. Rarely will an appellate court disturb a lower court's fact-finding determination.

Should you need more information, do not hesitate to contact me.

Sincerely,

Marilyn S. Crumbley
Tax Partner

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33. (LO 5)
TAX FILE MEMORANDUM

DATE: September 4, 2019

FROM: Sarah Flinn

RE: Telephone conversation with Will Thomas regarding the failure of the IRS to appeal

I explained to Mr. Thomas that there were numerous reasons why the IRS may decide not to appeal a decision it loses in a District Court. For example, the workload may be too heavy. Or the IRS may have decided that this particular case is not a good decision to appeal (e.g., sympathetic taxpayer). Third, the IRS might not want to appeal this case to the appropriate Court of Appeals. I stressed that the failure to appeal does not necessarily mean that the IRS agrees with the results reached.

34. (LO 5, 8)

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

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

c. The decision of a Court of Appeals will carry more weight than one rendered by a trial court. Since the taxpayer lives in California, however, any appeal from a District Court or the U.S. Tax Court would go to the Ninth Court of Appeals. Although the Ninth Court of Appeals might be influenced by what the Second Court of Appeals has decided, it is not compelled to follow such holding.

d. Since the U.S. Supreme Court is the top appellate court, complete reliance can be placed on its decisions. Nevertheless, one should investigate any decision to see whether the Code has been modified to change the results reached. The rare possibility also exists that the Court may have changed its position in a later decision.

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

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

35. (LO 6, 7) Aleshia has a number of approaches available, depending on the available materials. One approach is to begin with the keyword index in an online tax research service. Since the subject matter "§ 351 transfers" is somewhat self-contained, she could also start with the Internal Revenue Code and Treasury Regulations. The text identifies the major tax services that Aleshia could consult.

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Another approach for Aleshia is to use CCH's *Federal Tax Articles*. After looking up "§ 351 transfers" in the subject index, she should be able to find a number of articles written about this subject. In addition, Thomson Reuters publishes the *Index to Federal Tax Articles* that is organized using RIA's paragraph index system. She also should check Bloomberg BNA *Tax Management Portfolios*.

36. (LO 7) Some tax researchers begin with a keyword search on an online tax service. If the problem is not complex, the researcher may bypass a tax service and turn directly to the Internal Revenue Code and the Treasury Regulations (both are available online; see Exhibit 1.7). For the beginner, this process saves time and will solve many of the basic problems. If the researcher does not have access to the Code or Regulations, the resources of a tax service may be necessary. Several of the major tax services publish paperback editions of the Code and Treasury Regulations that can be purchased at modest prices.

37. (LO 8)
a. Primary source.

b. Secondary source.

c. Primary source.

d. Secondary source, but substantial authority for purposes of the accuracy-related penalty in § 6662.

e. Secondary source.

38. (LO 9) The key components of effective tax planning are as follows:

- Avoid the recognition of income (usually by resorting to a nontaxable source or nontaxable event).
- Defer recognition of income (or accelerate deductions).
- Convert the classification of income (or deductions) to a more advantageous form (e.g., ordinary income into capital gain).
- Choose the business entity with the desired tax attributes.
- Preserve formalities by generating and maintaining supporting documentation.
- Act in a manner consistent with the intended objective.

Don't just focus on tax considerations. Keep generally accepted accounting principles, sound business judgment, and overall economic outcomes in mind as well.

39. (LO 10) Simulations are task-based studies designed to test a candidate's tax knowledge and skills using real-life, work-related situations. Simulations include a four-function pop-up calculator, a blank spreadsheet with some elementary functionality, and authoritative literatures appropriate to the subject matter. The taxation database includes authoritative excerpts (e.g., Internal Revenue Code and Regulations, IRS publications, and Federal tax forms) that are necessary to complete the tax case study simulations.

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PROBLEMS

40. (LO 2)

a. Juniper has a realized gain of $200,000 determined as follows:

Amount received on the exchange:		
FMV of real estate received	$900,000	
Cash	100,000	$1,000,000
Amount given up on the exchange:		
Basis of real estate		(800,000)
Realized gain		$ 200,000

Juniper's recognized gain is limited to the *lesser* of realized gain of $200,000 or the other property (boot) received of $100,000. Thus, the recognized gain is limited to other property (boot) received of $100,000 [the amount of cash (boot) received by Juniper]. Refer to § 1031.

b. Birch has a realized loss of $300,000, determined as follows:

Amount received on the exchange		$1,000,000
Amounts given up on the exchange:		
Real estate (basis)	$1,200,000	
Cash	100,000	
Basis of property given up		(1,300,000)
Realized loss		$ (300,000)

None of Birch's realized loss can be recognized.

c. Under the wherewithal to pay concept, forcing Juniper to recognize a gain of $100,000 makes sense. Because of the $100,000 cash received, not only has Juniper's economic position changed, but it now has the means to pay the tax on the portion of the realized gain that is recognized.

The disallowance of Birch's realized loss is consistent with the usual approach of the wherewithal to pay concept. This disallowance is the price that must be paid for tax-free treatment, and a carryover basis and adjustment under § 1031(d) prevents a deterioration of Birch's tax position. Note: After the exchange, Birch has a basis of $1,300,000 in the real estate received from Juniper [i.e., $1,200,000 (basis in the real estate given up) + $100,000 (cash given up)].

41. (LO 2, 3)

a. W. Wherewithal to pay concept.

b. CE. Control of the economy.

c. ESB. Encouragement of small business.

d. SC. Social considerations.

e. EI. Encouragement of certain industries.

f. AF. Administrative feasibility.

g. SC. Social considerations.

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42. (LO 2)

a. Louisiana, community property.

b. Virginia, common law.

c. Arizona, community property.

d. Rhode Island, common law.

e. Alaska, community property may be elected by spouses.

f. California, community property.

43. (LO 4) The real question is whether the parties acted in an arm's length manner. In other words, was the $100,000 selling price the true value of the property?

a. Where the parties to a transaction are related to each other, the IRS is quick to apply the arm's length concept. The IRS might, for example, find that the value of the property was less than $100,000. In this event, the difference probably is dividend income to Benny.

b. The same danger exists even if Benny (the seller) is not a shareholder in Jet Corporation (the purchaser) as long as he is related to the one in control. If the value of the property is less than $100,000, the IRS could argue for a constructive dividend to Benny's father of any difference. Because Benny ended up with the benefit, it follows that the father has made a gift to the son of such difference (see discussion in Chapter 5).

c. Since Benny is not a shareholder in Jet Corporation and is not related to any of its shareholders, the IRS probably would not question the $100,000 selling price or the substance of the sale.

d. The student e-mail should summarize the items above. Look for proper grammar and e-mail etiquette in addition to the correct answer.

44. (LO 5)

a. Letter rulings are issued for a fee by the National Office of the IRS upon a taxpayer's request and describe how the IRS will treat a proposed transaction for tax purposes. In general, they apply only to the taxpayer who asks for and obtains the ruling, but post-1984 rulings may be substantial authority for purposes of avoiding the accuracy-related penalties.

b. The National Office of the IRS releases technical advice memoranda (TAMs) weekly. TAMs resemble letter rulings in that they give the IRS's determination of an issue. Letter rulings, however, are responses to requests by taxpayers, whereas TAMs are issued by the National Office of the IRS in response to questions raised by taxpayers or IRS field personnel during audits. TAMs deal with completed rather than proposed transactions and are often requested for questions relating to exempt organizations and employee plans. Although TAMs are not officially published and may not be cited or used as precedent, post-1984 TAMs may be substantial authority for purposes of the accuracy-related penalties.

45. (LO 5)

a. Revenue Procedure number 10, appearing on page 272 of Volume 1 of the *Cumulative Bulletin* for 2001.

b. Revenue Ruling number 14 appearing on page 31 of the 27th weekly issue of the *Internal Revenue Bulletin* for 2011.

c. The 30th letter ruling issued during the 25th week of 2011.

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46. (LO 6)
a. IRC.

b. FR, IRB, CB.

c. IRB, CB.

d. FR, IRB, CB.

e. IRB, CB.

f. NA, a court decision.

g. NA, a letter ruling.

47. (LO 5)
a. Fifth Circuit.

b. Tenth Circuit.

c. Eleventh Circuit.

d. Ninth Circuit.

e. Second Circuit.

48. (LO 5)
a. A

b. T

c. U

d. T

e. T

f. C

g. N

h. D

49. (LO 6)
a. *United States Tax Reporter* is published by Research Institute of America, Thomson Reuters.

b. *Standard Federal Tax Reporter* is published by Commerce Clearing House, Inc.

c. *Federal Tax Coordinator 2d* is published by Research Institute of America.

d. *Mertens Law of Federal Income Taxation* is published by Thomson Reuters.

e. *Tax Management Portfolios* is published by Bloomberg BNA.

f. *CCH Tax Research Consultant* is published by Commerce Clearing House, Inc.

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50. (LO 5, 8)

a. P.

b. P.

c. P.

d. P.

e. S.

f. P.

g. S.

h. P.

i. B. Primary to the taxpayer to whom issued, but secondary for all other taxpayers.

j. P.

k. S. Cannot be cited as precedent.

l. P.

m. S.

n. S. Courts generally do not recognize proposed regulations.

51. (LO 5)

a. For a regular decision of the U.S. Tax Court that was issued in 1970. The decision can be found in Volume 54, page 1514, of the *Tax Court of the United States Reports*, published by the U.S. Government Printing Office.

b. For a decision of the U.S. Second Circuit Court of Appeals that was rendered in 1969. The decision can be found in Volume 408, page 1117, of the *Federal Reporter*, Second Series (F. 2d), published by West Publishing Company.

c. For a decision of the U.S. Second Circuit Court of Appeals that was rendered in 1969. The decision can be found in Volume 1 for 1969, paragraph 9319, of the *U.S. Tax Cases*, published by Commerce Clearing House.

d. For a decision of the U.S. Second Circuit Court of Appeals that was rendered in 1969. The decision can be found in Volume 23, page 1090, of the Second Series of *American Federal Tax Reports*, now published by RIA (formerly P-H).

[Note that the citations that appear in parts b., c., and d. are for the same case.]

e. For a decision of the U.S. District Court of Mississippi that was rendered in 1967. The decision can be found in Volume 293, page 1129, of the *Federal Supplement Series*, published by West Publishing Company.

f. For a decision of the U.S. District Court of Mississippi that was rendered in 1967. The decision can be found in Volume 1 for 1967, paragraph 9253, of the *U.S. Tax Cases*, published by Commerce Clearing House.

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g. For a decision of the U.S. District Court of Mississippi that was rendered in 1967. The decision can be found in Volume 19, page 647, of the Second Series of *American Federal Tax Reports*, now published by RIA (formerly P-H).

[Note that the citations that appear in parts e., f., and g. are for the same case.]

h. For a decision of the U.S. Supreme Court that was rendered in 1935. The decision can be found in Volume 56, page 289, of the *Supreme Court Reporter*, published by West Publishing Company.

i. For a decision of the U.S. Supreme Court that was rendered in 1935. The decision can be found in Volume 1 for 1936, paragraph 9020, of the *U.S. Tax Cases*, published by Commerce Clearing House.

j. For a decision of the U.S. Supreme Court that was rendered in 1935. The decision can be found in Volume 16, page 1274, of the *American Federal Tax Reports*, now published by RIA.

[Note that the citations that appear in parts h., i., and j. are for the same case.]

k. For a decision of the former U.S. Court of Claims that was rendered in 1970. The decision can be found in Volume 422, page 1336, of the *Federal Reporter*, Second Series, published by West Publishing Company. This court is the Claims Court (renamed the Court of Federal Claims effective October 30, 1992), and current cases are in the *Federal Claims Reporter*.

RESEARCH PROBLEMS

1. a. Section 6694(a) deals with the penalty for understatements due to taking an unreasonable position on a tax return.

b. Reg. § 1.6694–1(b) deals with the meaning of the term *tax preparer* for purposes of the tax preparer penalties.

c. Revenue Ruling 86–55 deals with tax return preparers and the assignment of refund checks.

d. PLR 8022027 deals with whether a tax return preparer is liable for a § 6694 penalty when he prepares a return claiming an IRA contribution that was not yet made and does not later ascertain that the contribution was made by the due date of the return.

2. a. *rev'd* 929 F.2d 1252 (CA–8, 1991).

b. *aff'd* 734 F.2d 20 (CA–9, 1984), *cert. den*., 469 U.S. 857 (1984).

c. *aff'd* 341 F.2d 341 (CA–5,1965).

d. *aff'd per curiam*, 487 F.2d 515 (CA–8, 1973).

e. *rev'd* 335 F.2d 507 (CA–6, 1964).

3. The vacation may not be 100% free. Australia paid around $2.7 million of the costs for the 300 vacations, but the trip is considered a taxable prize or award under IRC § 74(a) and not a nontaxable gift. Reg. § 1.74–1(a)(1) requires all amounts received as prizes and awards (unless such prizes or awards qualify as an exclusion from gross) to be included in gross income. Prizes and awards that are includible in gross

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income include amounts received from radio and television giveaway shows. Reg. § 1.74–1(a)(2) further states that if the prize or award is not made in money but is made in goods or services, the fair market value of the goods or services is the amount to be included in income. Thus, the lucky recipients would have to pay taxes on the fair market value of the trip, not the amount actually paid for the trip by the Oprah show.

Oprah stated that she was paying any taxes of the lucky fans. Under *Old Colony Trust Co.*, 279 U.S. 716 (1929), the amount of any tax liability paid by Oprah is also taxable income. See Reg. § 1.61–14. If the initial tax liability is paid, another amount is taxable. Thus, an infinite amount of taxes would need to be paid by Oprah to make the vacation trip totally tax-free. The only way to make the prize tax-free is for Oprah to "gross up" the prize for any taxes due. Keep in mind there are also probably state taxes to be paid. All in all, this tax problem should create a lot of work for the accountant that Oprah chose to handle the tax problems of the 300 taxpayers.

Research Problems 4 and 5

These research problems require that students utilize online resources to research and answer the questions. As a result, solutions may vary among students and courses. You should determine the skill and experience levels of the students before assigning these problems, coaching where necessary. Encourage students to use reliable websites and blogs of the IRS and other government agencies, media outlets, businesses, tax professionals, academics, think tanks, and political outlets to research their answers.

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CHECK FIGURES

40.a. Realized gain $200,000; recognized gain $100,000.

40.b. Realized loss $300,000; recognized loss $0.

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SOLUTION TO ETHICS & EQUITY FEATURE

Choosing Cases for Appeal (p. 1-35). The issue is whether it is appropriate for the Government to select a case to appeal because of its potential for success (i.e., a reversal on appeal) rather than purely on its merits.

Without question, the tax laws treat taxpayers differently and often unfairly. Many laws are passed as the result of pressure from various groups (i.e., lobbying). "Don't tax you, don't tax me, tax that fellow behind the tree" is an appropriate statement of tax law development in many circumstances.

Part of the IRS's function is to maximize revenue with the limited time and budget resources at its disposal. By litigating specific cases in order to develop judicial law, the IRS does "save" taxpayers' dollars by avoiding marginal issues. And if the IRS position is sustained on appeal in Virginia, the judicial precedent might be important should the IRS choose to appeal the Iowa decision.

Certainly, there is an unfairness in such an approach. If the IRS decides to appeal the Virginia case, the CPA must bear the burden of litigation expenses (rather than the minister). Further, should the IRS position be sustained on appeal, the CPA's trusts would be collapsed while the minister's trusts may be allowed to remain—even though the tax issues are identical.

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CHAPTER 1

UNDERSTANDING AND WORKING WITH THE FEDERAL TAX LAW

LECTURE NOTES

OVERVIEW

Former IRS Commissioner Sheldon Cohen indicates that "taxes are dry, arcane and difficult, but tell me a person's philosophy of taxes, and I will tell you his or her philosophy of life."

The tax law is complex and some of its provisions sometimes defy logic. Most often, there are reasons for the tax rules. One may not agree with the reasons, but, nonetheless, they exist. Knowing these reasons can go a long way in helping to understand the tax law. This knowledge is what Chapter 1 conveys. Chapter 1 also provides an instructor with the opportunity to review some of the concepts covered in the first course in taxation.

SUMMARY OF CHANGES IN THE CHAPTER

The following are notable changes in the chapter from the 2019 Edition.

- Updated references and citations throughout the chapter.
- Modified discussion of the Small Claims Division of the U.S. Tax Court.
- Updated discussion on changes to the CPA exam.
- Updated end-of-chapter materials as needed.

THE BIG PICTURE

Dana loans her nephew $93,000 in 2012 for college. Seven years later, after receiving only $16,000 of repayments, Dana asks about the possibility of deducting the remainder as a bad debt.

- What planning tips might you give Dana?
- What mistakes were made?

THE WHYS OF THE TAX LAW

1. While the primary objective of Federal tax law is raising revenue, this is *not* the sole objective of tax laws.

   a. Important in explaining various provisions found in the law are economic, social, equity, and political considerations.

   b. The IRS and the courts also impact the tax law.

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Revenue Needs

2. Raising revenue to fund the cost of government operations is the key factor in structuring a tax system.

3. Over the past century, the national debt has been increasing significantly, reaching more than $21.7 trillion, or more than $178,000 per taxpayer, in November 2018.

4. When enacting legislation, Congress is guided by the concept of revenue neutrality.

   a. Changes in the tax law should neither increase nor decrease the net revenues collected.

   b. There are likely to be both "winners" (taxpayers who see a reduction in taxes paid) and "losers" (taxpayers who see an increase in taxes paid).

Economic Considerations

5. Tax law is often used to accomplish economic objectives.

6. Control of the Economy. Congress has used the tax depreciation system as one means of controlling the economy.

   a. Shorter asset lives and accelerated methods should encourage additional investments in depreciable business property.

   b. Longer asset lives and the use of straight-line depreciation should discourage capital outlays.

   c. Congress also uses incentives like immediate expensing (§ 179) and bonus depreciation to stimulate the economy when needed.

   d. When tax rates are lowered, taxpayers retain money that can be used for other purposes.

   e. If Congress is using the concept of revenue neutrality, rate reductions may be offset by a reduction or elimination of deductions or credits. As a result, lower rates do not always mean lower taxes.

7. Encouragement of Certain Activities.

   a. Research and development expenditures can be deducted in the year incurred or, alternatively, capitalized and amortized over a period of 60 months or more.

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b. Inventions are encouraged under tax law. Patents can qualify as capital assets, and, under certain conditions, their disposition automatically carries long-term capital gain treatment.

c. Ecology is encouraged by allowing pollution control facilities to be amortized over 60 months (rather than over the 39-year period required for most business buildings).

d. Saving, which leads to capital formation, is stimulated by incentives to increase private retirement plans. The encouragement of private-sector pension plans can be justified under social considerations as well.

8. Encouragement of Certain Industries.

a. Tax laws favor farming by allowing expensing of soil and water conservation and fertilizers. Also, farmers can defer the gain recognition on crop insurance proceeds.

b. Natural resource exploration and development are encouraged by allowing expensing of intangible drilling and development costs. Also, percentage depletion often allows a larger write-off for mineral interests that qualify.

c. The railroad and banking industries also receive special tax treatment.

9. Encouragement of Small Business. Several provisions illustrate a desire to benefit small business. These include the following:

a. Special treatment of small business corporation stock leading to ordinary (rather than capital) loss treatment (§ 1244 stock).

b. S corporation elections allow the avoidance of corporate income tax and the pass-through of losses to the shareholders.

Social Considerations

10. Many of the tax provisions passed by Congress can be explained by social desirability.

a. These provisions encourage individuals to work, give to charities, and obtain an education.

b. Employers are encouraged to provide accident, health, and group term life insurance as well as retirement plans for employees.

Equity Considerations

11. Equity is a relative concept, and people often disagree as to what is equitable. For tax purposes, equity is equal application of what the tax law recognizes.

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12. Alleviating the Effect of Multiple Taxation. Several provisions are intended to alleviate the effect of multiple taxation.

    a. Federal tax law allows a taxpayer to claim a deduction for some state and local income taxes. The deduction, however, does not eliminate the effect of multiple taxation.

    b. Because double taxation results when the same income is subject to both foreign and U.S. income taxes, the tax law permits the taxpayer to choose either a credit or a deduction for the foreign taxes paid.

    c. Triple taxation relief for corporations is provided by a deduction for dividends received from certain domestic corporations. In the case of individual shareholders, they receive a reduced rate of tax (from 0% for lower tax bracket shareholders to 20% for certain high-income shareholders).

    d. For the Federal estate tax, several provisions reflect attempts to mitigate the effect of multiple taxation.

        (1) A limited credit against the estate tax for foreign death taxes imposed is allowed.

        (2) Other estate tax credits are available and can be explained on the same grounds.

13. The Wherewithal to Pay Concept. This concept is based on equity. It recognizes that it is inequitable to tax transactions when the taxpayer has no ability to pay the tax.

    a. Applies only where Congress specifically provides; thus, one cannot conclude that a transaction is nontaxable just because no cash results from the exchange.

    b. Most wherewithal to pay provisions in the tax law do not permanently avoid gain or loss but operate on a deferral principle. Because of the basis carryover rules, gain or loss merely is postponed to the future disposition.

14. Mitigating the Effect of the Annual Accounting Period Concept. For administrative ease, all taxpayers have to file tax returns yearly. However, all taxpayers do not have a one-year business cycle. To mitigate the effect of annual accounting period concepts, taxpayers are allowed the following:

    a. Deductions for net operating losses that occur in other tax years.

    b. The installment method.

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c. Deduction determination after the year-end when it is difficult to accurately assess the proper amount by year-end. Examples are contributions to IRA and H.R. 10 (Keogh) retirement plans.

15. Coping with Inflation. To overcome the impact of inflation in many areas of the tax law, Congress has included an indexing procedure.

Political Considerations

16. Special Interest Legislation. Special interest legislation provides benefits to limited groups of taxpayers. However, this legislation should not be condemned if justified on economic or social grounds.

17. Political Expediency. Congress is sensitive to the general public's sentiment regarding taxes. Provisions like the imputed interest rules and the limitation on the deductibility of interest on investment indebtedness can be explained on this basis.

18. State and Local Government Influences. State and local influences on Federal taxation may be less apparent. The community property system is an example.

Influence of the Internal Revenue Service

19. The IRS as Protector of the Revenue. The IRS is influential in many areas beyond its role in issuing administrative pronouncements. It is proactive in closing "loopholes" in tax laws.

20. Administrative Feasibility. Some tax laws are justified on the grounds that they simplify collecting the revenue and administering the law.

a. Such items as the pay-as-you-go basis for collecting taxes and the imposition of interest and penalties on taxpayers for noncompliance with the tax law help ease revenue collection.

b. Laws to aid in the audit process conducted by the IRS.

(1) Standard deduction reduces the number of taxpayers claiming itemized deductions. Fewer deductions to check simplifies the audit function.

(2) The annual gift exclusion is $15,000.

Influence of the Courts

21. Judicial Concepts Relating to Tax Law.

a. Substance over form is one of the most important tax concepts developed by the courts.

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b. The step transaction approach (also called the telescoping or collapsing process) allows the tax law to disregard any step in a transaction involving many steps, if the results would be the same.

c. The arm's-length transaction concept suggests that transactions should be constructed such that unrelated parties would have handled the transaction in the same manner.

d. Continuity of interest, which applies primarily to corporation restructuring, has been incorporated into statutory provisions.

e. Business purpose concepts principally apply to corporations. Tax avoidance is not considered to be a sound business purpose.

22. Judicial Influence on Statutory Provisions. Courts interpret the tax law and may have substantial impact on statutory provisions.

a. Congress generally accepts the decisions of the courts, and those decisions become part of the tax law. In some cases, Congress may see fit to incorporate the result of a decision and make it part of the tax law.

b. On occasion, a decision leads to uncertainty by failing to provide guidelines for similar but not identical factual situations. To clarify the matter, Congress may amend the tax law to establish such guidelines.

c. If Congress does not choose to accept a judicial decision, it can change the tax law to neutralize the result. Congress has the last word on what the Federal tax law should be barring certain exceptions (e.g., constitutional issues).

SUMMARY

23. In addition to revenue raising, the Federal tax law is influenced by economic, social, equity, and political considerations.

24. Influence of the IRS and the courts are also instrumental in the development of tax laws.

RECONCILING ACCOUNTING CONCEPTS

25. The vast majority of an entity's business transactions receive the same treatment for financial accounting purposes as they do under Federal and state tax law. But "book-tax differences" exist. These are differences between Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS) and tax rules.

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WORKING WITH THE TAX LAW—TAX SOURCES

26. The primary sources of tax law include information from all three branches of government: legislative (or statutory), executive, and judicial.

27. Learning to work with the tax law involves three basic steps:

    1. Familiarity with the sources of the law.
    2. Application of research techniques.
    3. Effective use of planning procedures.

Statutory Sources of the Tax Law

28. Origin of the Internal Revenue Code.

    a. Before 1939, the tax law provisions were not codified.

    b. The first codification was in 1939 and the recodification was in 1954.

    c. The Internal Revenue Code of 1986 *was not* a recodification of the tax law. To emphasize the magnitude of the changes made by the Tax Reform Act of 1986, the Code title was changed.

29. The Legislative Process. For an illustration of the legislative process, see Exhibit 1.1 in the text.

    a. Committee reports are an important source for ascertaining the intent of Congress when passing new tax laws. These are key for interpreting legislation, especially before Regulations have been issued.

    b. The role of the Joint Conference Committee indicates the importance of compromise in the legislative process.

    c. Exhibit 1.2 in the text illustrates what happened in the Tax Cuts and Jobs Act (TCJA) of 2017 regarding corporate tax rates and a new qualified business income deduction for noncorporate taxpayers.

30. Arrangement of the Internal Revenue Code.

    a. In referring to a provision of the Code, the key is usually the Section number.

    b. Tax researchers often refer to a specific area of income taxation by Subchapter designation.

31. Citing the Code.

    a. Proper citation formats are presented on text page 1-16.

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b. Some Code section citations contain a capital letter (e.g., § 280A to § 280H). This is because certain Code numerical sequences have no space for expansion.

Administrative Sources of the Tax Law

32. Administrative sources are issued by either the U.S. Treasury Department or the IRS.

33. Treasury Department Regulations. Under § 7805, the Treasury Department has a duty to issue rules and Regulations to explain and interpret the Code.

a. Regulations, which carry considerable authority as the official interpretation of tax law, may be issued in proposed, temporary, or final form.

b. Because they interpret the Code, Regulations are arranged in the same manner as the Code but have a prefix indicating the type of tax to which they apply.

34. Revenue Rulings and Revenue Procedures. Official pronouncements of the National Office of the IRS.

a. Revenue Rulings (Rev.Rul.) are official pronouncements of the National Office of the IRS and are designed to provide interpretation of the tax law, although they do not carry the same legal force and effect as Regulations.

b. Revenue Procedures (Rev.Proc.) deal with the internal management practices and procedures of the IRS.

c. Both serve to provide guidance to IRS personnel and taxpayers in handling routine tax matters.

d. Both are published weekly by the U.S. Government in the *Internal Revenue Bulletin* (I.R.B.).

e. Proper citation formats are presented on text page 1-19.

f. Revenue Rulings and other tax resources may be found at the IRS website: **irs.gov**.

35. Other Administrative Pronouncements.

a. Letter Rulings (Ltr.Rul. or PLR) are issued by the National Office of the IRS upon a taxpayer's request and describe how the IRS will treat a proposed transaction for tax purposes.

(1) They apply only to the taxpayer who asks for and obtains the ruling.

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(2) The IRS must make letter rulings available for public inspection after identifying details are deleted.

b. Technical Advice Memorandums (TAMs) are issued by the National Office of the IRS and resemble letter rulings. However, they are issued in response to questions raised during audits. TAMs deal with completed rather than proposed transactions.

c. Proper citation format for Ltr.Rul. and TAM with explanations are presented on text page 1-19.

d. Letter rulings and TAMs issued before 2000 are often cited with only two-digit years (e.g., Ltr.Rul. 9933108).

e. Like letter rulings, determination letters are issued at the request of taxpayers and provide guidance concerning the application of the tax law. They differ from individual rulings in that:

(1) The issuing source is an IRS Area Director (rather than the National Office of the IRS).

(2) Determination letters usually involve completed (as opposed to proposed) transactions.

(3) Determination letters are not published by the government and are made known only to the party making the request.

Judicial Sources of the Tax Law

36. The Judicial Process in General.

a. Once a taxpayer has exhausted remedies available within the IRS, the dispute can be taken to the Federal courts.

(1) The dispute is first considered by a court of original jurisdiction (trial court).

(2) Appeals may be taken to the appropriate appellate court.

(3) The Federal trial and appellate court system is illustrated in Exhibit 1.4 in the text.

b. The Small Cases Division of U.S. Tax Court hears informal cases of $50,000 or less. The ruling of the judge is final (no appeal is available), and these rulings are not precedent for any other cases.

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c. American law, following English law, is frequently "created" by judicial decisions. Under the doctrine of *stare decisis*, each case has precedential value for future decisions with the same controlling set of facts.

37. Trial Courts. Courts in which a taxpayer may pursue a tax conflict are as follows:

a. The U.S. Court of Federal Claims hears tax and other Federal government cases. It has 16 judges.

b. The U.S. Tax Court hears only tax cases. It has 19 judges.

c. There are numerous U.S. District Courts based on geographical location. Each court has one judge and taxpayers can have a jury trial.

d. Concept Summary 1.1 in the text provides a summary of the organization of the tax trial courts.

38. Appellate Courts. Appeals from trial courts are to the U.S. Court of Appeals for the appropriate jurisdiction. (Exhibit 1.5 in the text illustrates the jurisdictions of the Federal Courts of Appeals.)

a. Generally, a three-judge panel hears a case, but occasionally the full court will decide more controversial conflicts.

b. If the IRS or taxpayer loses at the trial court level, either or both may appeal. When it loses, the IRS may choose not to appeal for a number of reasons.

c. *Appealing from the Tax Court.* The Tax Court is a national court, meaning that it hears and decides cases from all parts of the country.

(1) Under the *Golsen* rule, the Tax Court decides a case as it believes the law should be applied only if the Court of Appeals of appropriate jurisdiction has not yet ruled on the issue or has previously affirmed the Tax Court's rationale.

(2) If the Court of Appeals has ruled on a case similar to the one being heard by the Tax Court, the Tax Court will conform to the Appeals Court decision under the *Golsen* rule, even though it disagrees with the decision.

d. *Appeal to the U.S. Supreme Court.*

(1) Appeal to the U.S. Supreme Court requires a Writ of Certiorari.

(2) If the Court agrees to hear the case, it grants the Writ but most often, it will deny.

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(3) Court grants certiorari to resolve a conflict among the courts or when the tax issue is extremely important.

(4) All individuals and the IRS must follow the decisions of the U.S. Supreme Court.

39. Judicial Citations. Proper judicial citation formats for all court cases are presented on text pages 1-24 through 1-27 and summarized in Concept Summary 1.2 in the text.

40. For additional reinforcement of locating judicial sources, consider using Figure 1-1 at the end of these Lecture Notes.

Other Sources of the Tax Law

41. Tax Treaties. Tax conventions (treaties) are signed by the United States and foreign countries to render mutual assistance in tax enforcement and to avoid double taxation. Neither a tax law nor a tax treaty takes general precedence. When there is a conflict, the most recent item will take precedence.

42. Tax Periodicals. Online sources of various periodicals are listed on text page 1-28.

WORKING WITH THE TAX LAW—LOCATING AND USING TAX SOURCES

Commercial Tax Services

43. In the past, commercial tax services could be classified as annotated (i.e., organized by Internal Revenue Code) or topical (i.e., organized by major topics). However, as tax research has become electronic, this classification system is no longer appropriate.

44. A partial list of the available commercial tax services includes:
- *Standard Federal Tax Reporter*, Commerce Clearing House.
- CCH *IntelliConnect*, Commerce Clearing House—the online version of the *Standard Federal Tax Reporter* (along with other CCH materials).
- *United States Tax Reporter*, Research Institute of America, Thomson Reuters.
- Thomson Reuters *Checkpoint*, Research Institute of America—the online version of RIA's *Federal Tax Coordinator 2d* and *United States Tax Reporter*.
- *Practical Tax Expert*, CCH/Wolters Kluwer.
- *Tax Management Portfolios*, Bloomberg BNA.
- *Mertens Law of Federal Income Taxation*, Thomson Reuters.
- Thomson Reuters *Westlaw* and *WestlawNext*—compilations include access to *Tax Management Portfolios*, *Federal Tax Coordinator 2d*, and *Mertens*.
- LexisNexis *Tax Center*—a compilation of primary sources and various materials taken from CCH, Matthew Bender, Kleinrock, and Bloomberg BNA.

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Using Electronic (Online) Tax Services

45. A competent tax professional must become familiar and proficient with electronic research services and be able to use them to complete research projects efficiently.

46. To simplify the research process, the following suggestions may be helpful:

    a. Carefully choose keywords for the search.

    b. Take advantage of connectors to place parameters on the search and further restrict the output.

    c. Be selective in choosing the data to search.

    d. Use a table of contents, index, or citation when appropriate.

Noncommercial Electronic (Online) Tax Sources

47. The internet provides a wealth of tax information in several popular forms, that allow a tax professional to access a significant amount of information that can aid the research process.

    a. Websites are provided by accounting and consulting firms, publishers, tax academics, libraries, and governmental bodies as a means of making information widely available.

        (1) One of the best sites available to the tax professional is the Internal Revenue Service's home page, illustrated in Exhibit 1.6 of the text.

        (2) Exhibit 1.7 in the text lists some of the websites that may be most useful to tax researchers.

    b. Blogs and RSS sites provide a means by which information related to the tax law can be exchanged among taxpayers, tax professionals, and others who subscribe to the group's services.

WORKING WITH THE TAX LAW—TAX RESEARCH

48. Tax research is the process of finding a competent and professional conclusion to a tax problem. The tax research process is illustrated in Exhibit 1.8 in the text.

Identifying the Problem

49. Problem identification starts by documenting the relevant facts involved. All of the facts that might be relevant must be gathered; if any facts are omitted, the solution provided will likely change.

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50. Refining the Problem. The problem will be refined during the research process as research is an iterative rather than a lineal process.

51. Further Refinement of the Problem. The problem will be further refined during the research process as research is an iterative rather than a lineal process.

Locating the Appropriate Tax Law Sources

52. Once a problem is clearly defined, the next step is a matter of individual judgment, but most tax research begins with a keyword search using an electronic tax service.

53. If the problem is not complex, the researcher may turn directly to the Internal Revenue Code and the Treasury Regulations. The Code and Regulations are available in print form (and accessible electronically).

Assessing the Validity of Tax Law Sources

54. The tax sources identified as relevant to the tax problem need to be interpreted and assessed as to their legal weight and validity.

55. Interpreting the Internal Revenue Code. Language of the Code is often complex: therefore, it must be read carefully, watching particularly for restrictive language and definitions that vary from one Code section to another.

56. Assessing the Validity of a Treasury Regulation.

    a. Treasury Regulations may have the force and effect of law; however, courts have held a Regulation or a portion invalid if contrary to the intent of Congress. Burden of proof is on the taxpayer to show that the Regulation should be invalidated.

    b. Regulations that merely reprint or rephrase what Congress has stated in its Committee Reports are almost impossible to overturn.

    c. Through the Code, Congress may give the "Secretary or his delegate" the authority to prescribe Regulations to administer or otherwise provide operating tax rules. Since Congress has delegated its legislative powers to the Treasury Department, these legislative Regulations have the power of law.

57. Assessing the Validity of Other Administrative Sources of the Tax Law. While Revenue Rulings issued by the IRS carry less weight than Regulations, they do reflect the position of the IRS on tax matters.

58. Assessing the Validity of Judicial Sources of the Tax Law. How much reliance can be placed on a particular decision depends upon the level of the court, the residence of the taxpayer, whether the decision represents the weight of authority on the issue, and the outcome or status of the decision on appeal.

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59. Assessing the Validity of Other Sources.

    a. The IRS regards only primary sources as substantial authority. Primary sources include the Constitution, legislative history materials, statutes, treaties, judicial decisions, Treasury Regulations, and IRS pronouncements.

    b. While secondary sources are not substantial authority, they still may be very useful. Some, such as letter rulings, general counsel, and technical advice memoranda, can bring protection from accuracy-related penalties. The general explanation of tax legislation prepared by the Joint Committee on Taxation ("Bluebook") can also provide protection from accuracy penalties.

Arriving at the Solution or at Alternative Solutions

60. After evaluating the tax law and applying it to the facts of the tax problem, a solution to the tax issues must be developed by applying professional judgment.

    a. The research may not result in a clear solution either because the law is not clear on the issue or due to incomplete knowledge of the tax facts. Thus, alternative treatments may be presented.

    b. The personal risk preference and clients' desired outcome must be considered.

Communicating Tax Research

61. Once the conclusions have been reached, they must be communicated to the supervisor and the client.

    a. Format may be in memo, letter, or spoken presentation.

    b. Good tax research communication should contain the following elements:
    - Clear statement of the issue.
    - Short review of the facts that raised the issue.
    - Review of relevant tax law sources.
    - Any assumptions made in arriving at the solution.
    - Solution recommended and the logic or reasoning supporting it.
    - References consulted in the research process.

62. Exhibits 1.9, 1.10, and 1.11 in the text present a sample client letter and memoranda for the tax files based on the facts of The Big Picture.

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WORKING WITH THE TAX LAW—TAX PLANNING

Nontax Considerations

63. Tax considerations can operate to impair sound business judgment. Tax and nontax considerations should be balanced.

Components of Tax Planning

64. The key components of tax planning include the following:

    a. Avoid the recognition of income (usually by resorting to a nontaxable source or nontaxable event). For example, passing property by death avoids income tax on any built-in appreciation.

    b. Defer the recognition of income (or accelerate deductions). For example, like-kind exchanges (§ 1031) and involuntary conversions (§ 1033) defer gain; installment sales both postpone and spread the recognition of gain.

    c. Convert the classification of income (or deductions) to a more advantageous form. For example, converting inventory to investment property may change ordinary income to capital gain; § 1244 converts a stock loss from capital to ordinary.

    d. Choose the business entity with the desired tax attributes. For example, partnerships and S corporations avoid double taxation of business income and allow the pass through of losses. Partnerships allow more flexibility in the allocation of income among owners than do S corporations but may subject them to more self-employment tax.

    e. Preserve formalities by generating and maintaining supporting documentation. For example, transfers from shareholders to a corporation treated as a loan rather than as a contribution to capital will allow subsequent distributions to be treated as deductible interest rather than nondeductible dividends.

    f. Act in a manner consistent with the intended objective. For example, a taxpayer claiming to be a dealer when selling land for a loss cannot later claim to be an investor if a subsequent sale would yield a gain; a taxpayer making lifetime gifts cannot continue to control the property gifted.

65. There is a fine line between legal tax planning and illegal tax planning—tax avoidance versus tax evasion. However, the consequences are as vast as the differences between a lightning bug and lightning.

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

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

Follow-Up Procedures

66. Tax planning usually involves proposed, as opposed to completed, transactions. The tax law can change by the time the transaction is completed; therefore, additional research should be performed to check the current status of the tax law.

Tax Planning—A Practical Application

67. In reference to The Big Picture scenario, discuss what should be done to help protect Dana's bad debt deduction.

TAXATION ON THE CPA EXAMINATION

68. The revised CPA exam continues to test in the familiar four sections—Auditing and Attestation (AUD), Business Environment and Concepts (BEC), Financial Accounting and Reporting (FAR), and Regulation (REG).

69. The revised exam places less emphasis on remembering-and-understanding skills, enabling higher-level analysis and evaluation skills to be tested.

70. Elements of the revised exam include:

a. The number of task-based simulations, a highly effective way to assess higher-order skills, increased.

b. Total testing time is 16 hours (up from previous 14 hours).

c. Multiple-choice questions and task-based simulations each contribute about 50% toward the candidate's score in the AUD, FAR, and REG sections. In the BEC section, multiple-choice questions contribute about 50% of the scoring, with 35% coming from task-based simulations and 15% from written communication.

d. The revised CPA exam places less emphasis on multiple-choice questions, with about 50% of the total points (down from about 60% of the total points).

e. The revised CPA exam tests remembering and understanding, application, analysis, and evaluation (from Bloom's taxonomy). The previous CPA exam only tested for the first two of these items.

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Preparation Blueprints

71. To prepare for the revised CPA exam, candidates will be able to use new AICPA-developed blueprints that will replace the current Content Specification Outline (CSO) and Skill Specification Outline (SSO).

72. The blueprints contain about 600 representative tasks, which are aligned with the skills required of newly licensed CPAs, across the four exam sections.

Regulation Section

73. The REG section of the CPA exam is administered in five blocks called testlets, which feature multiple-choice questions (MCQs) and task-based simulations (TBSs). Candidates receive at least one research question (research-oriented TBS) that requires the candidate to search the applicable authoritative literature and find an appropriate reference.

74. There are five content areas in the REG section of the CPA exam:

    a. Area 1: Ethics, professional responsibilities, and Federal tax procedures (weight 10–20%).

    b. Area 2: Business law (weight 10–20%).

    c. Area 3: Federal taxation of property transactions (weight 12–22%).

    d. Area 4: Federal taxation of individuals (weight 15–25%).

    e. Area 5: Federal taxation of entities (weight 28–38%).

75. Content related to the TCJA of 2017 is eligible for testing on the CPA exam starting January 1, 2019. Beginning in 2019, there will be a simultaneous introduction of content related to the TCJA of 2017 and removal of content related to the previous tax law.

THE BIG PICTURE

If Dana truly intended the advance made to her nephew to be a loan, she should have documented that intent, along with formalizing all the characteristics normally associated with a loan including the interest rate, repayment dates, and penalties for failure to make scheduled repayments. Failure to preserve the formalities of the debt raises the possibility the advance will be viewed as a gift with no income tax consequences.

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ETHICS AND EQUITY FEATURES

Solutions to the Ethics & Equity features are located in the Solutions Manual.

RESEARCH PROBLEMS

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

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Figure 1-1

LOCATION OF JUDICIAL SOURCES

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

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

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

(c) Both CCH and RIA have separate services for reporting the decisions of the U.S. Tax Court (both regular and memorandum).

(d) All decisions (both tax and nontax) of the U.S. Court of Claims were published by the U.S. Government Printing Office in Court of Claims Reporter Series. Ceased publication September 30, 1982.

(e) From 1945 to 1960, the Court of Claims decisions were published by West Publishing Company in the F.Supp. Series; from 1960, to September 30, 1982, in the F.2d Series; from October 1, 1982, to September 30, 1992, in the Claims Court Reporter; and beginning October 1, 1992, in the Federal Claims Reporter.

(f) The reference to "all cases" pertains to nontax as well as tax cases. Thus, it would include such varied issues as interstate transportation of stolen goods, civil rights violations, and antitrust suits.

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