South Western Federal Taxation 2023 Comprehensive 46th edition Young Solutions Manual

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CHAPTER 2

WORKING WITH THE TAX LAW

SOLUTIONS TO PROBLEM MATERIALS

DISCUSSION QUESTIONS

1. (LO 1) Determining the intent of Congress is a large part of tax research. Reviewing the Committee Reports generated by the House Ways and Means Committee, the Senate Finance Committee, and the Joint Conference Committee (if convened) will assist in determining intent.

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

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

4. (LO 2, 5)

SWFT, LLP
5191 Natorp Boulevard
Mason, OH 45040

October 20, 2022

Ms. Sonja Bishop
Tile, Inc.
100 International Drive
Tampa, FL 33620

Dear Ms. Bishop:

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

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

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

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

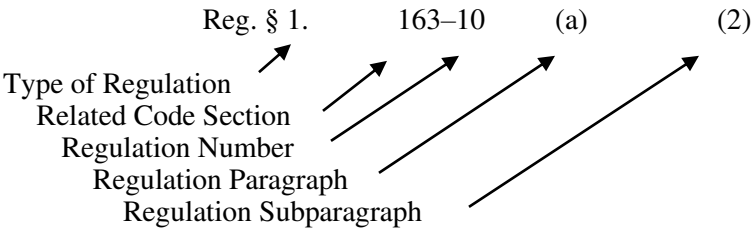
Sincerely,

Jeffrey Hanks, CPA
Tax Partner

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5. (LO 1, 2) Income tax



6. (LO 1) There are a number of limitations on the percentage of depletion deduction, but there is a limited exception for independent producers and royalty owners. This deduction, however, is not available for a taxpayer that is a retailer or refiner. But § 613A(d)(4) indicates that a percentage depletion deduction "shall not apply to the taxpayer for a taxable year if the average daily refinery runs of the taxpayer and such persons for the taxable year exceed 75,000 barrels." So as long as the independent producer is refining 75,000 barrels or less in a taxable year, the percentage depletion deduction will be available.

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

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

(2) Proposed Regulation (most courts ignore these)

(3) Revenue Ruling

(4) Interpretive Regulation

(5) Legislative Regulation

(6) Internal Revenue Code

8. (LO 1)

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

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

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

9. (LO 1, 5) TAX FILE MEMORANDUM

DATE: September 21, 2022

FROM: George Ames

SUBJECT: Telephone conversation with Sally Andrews on applicability of 2015 letter ruling

I informed Sally Andrews that only the taxpayer to whom the 2015 letter ruling was issued may rely on the pronouncement. I also stressed that a letter ruling has no precedential value under § 6110(k)(3).

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I pointed out that a letter ruling indicates the position of the IRS on the specific fact pattern presented as of the date of the letter ruling. As such, a letter ruling is not primary authority. However, under Reg. § 1.6662–4(d)(3), a letter ruling is substantial authority for purposes of the accuracy-related penalty in § 6662.

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

- For a fee, the IRS will issue a letter ruling at a taxpayer's request and describe how the IRS will treat a proposed transaction. The letter ruling applies only to the requesting taxpayer. A Revenue Ruling is applicable to all taxpayers.
- Sri must determine whether the possible tax amount is large enough to warrant the costs and time to apply for a letter ruling.
- If Sri is likely to obtain an adverse letter ruling from the IRS National Office, he should forgo the ruling request.
- The letter ruling would have substantial authority for purposes of the accuracy-related penalty.
- Sri needs to consult Rev.Proc. 2022–3 to be certain the IRS will issue a ruling about this tax issue. The IRS will not rule in certain areas that involve fact-oriented situations but will probably issue one here.

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

- *IRS Letter Ruling Reports* (CCH).
- Bloomberg BNA *Daily Tax Reports*.
- *Tax Notes* (Tax Analysts).
- Letter rulings are also available in electronic (online) tax research services (e.g., Thomson Reuters *Checkpoint*).

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

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

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

- How expensive will it be?
- How much time will be consumed?
- Does he have the temperament to engage in the battle?
- What is the probability of winning?

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

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

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

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

15. (LO 1, 5)

SWFT, LLP
5191 Natorp Boulevard
Mason, OH 45040

July 7, 2022

Mr. Eddy Falls
200 Mesa Drive
Tucson, AZ 85714

Dear Mr. Falls:

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

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

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

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The Court of Federal Claims, the third alternative, is a trial court that usually meets in Washington, D.C. It has jurisdiction for any claim against the United States that is based on the Constitution, any Act of Congress, or any regulation of an executive department. The main advantage of the U.S. Court of Federal Claims occurs when a taxpayer's applicable Circuit Court previously rendered an adverse decision. Such a taxpayer may select the Court of Federal Claims because any appeal will be to the Federal Circuit instead. One disadvantage of the Court of Federal Claims is that the tentative deficiency must be paid before the Court will hear and decide the controversy.

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

Sincerely,

Abby Reynolds, CPA
Tax Partner

16. (LO 1) The U.S. Tax Court hears only tax cases and is the most popular forum for tax cases (generally viewed as an advantage). Overall, Tax Court judges have more tax expertise; many had careers in the Treasury Department or the IRS before being appointed to the Tax Court. A taxpayer does not have to pay the tax deficiency assessed by the IRS before trial, but a taxpayer may deposit a cash bond to stop the running of interest (also viewed as an advantage). Appeals from a Tax Court are to the appropriate U.S. Court of Appeals. A disadvantage is that the taxpayer may not obtain a jury trial in the U.S. Tax Court.

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

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

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

c. Same as part b. above.

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

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

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

20. (LO 1) See Concept Summary 2.1.

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

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21. (LO 1) See Exhibit 2.5.

a. Tenth.

b. Eighth.

c. Ninth.

d. Fifth.

e. Seventh.

22. (LO 1) See Exhibit 2.4.

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

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

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

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

24. (LO 1, 2, 4)

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

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

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

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

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

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

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

26. (LO 1) There is no automatic right of appeal to the U.S. Supreme Court. Appeal is by Writ of Certiorari. If the Court agrees to hear the dispute, it will grant the Writ (*Cert. granted*). Most often, the highest court will deny jurisdiction (*Cert. denied*).

27. (LO 2) See Concept Summary 2.2.

a. Ninth Circuit Court of Appeals.

b. U.S. Tax Court.

c. U.S. Supreme Court.

d. Board of Tax Appeals (old name of U.S. Tax Court).

e. Tax Court (memorandum decision).

f. Court of Claims.

g. Not a court decision.

h. District Court in New York.

i. Not a court decision.

28. (LO 2) See Concept Summary 2.2.

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

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

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

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

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

f. This citation is to a decision of the U.S. First Circuit Court of Appeals that was rendered in 2007. The decision can be found in Volume 491, page 53, of the *Federal Reporter*, Third Series (F.3d), published by West Publishing Company.

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g. This citation is to a decision of the U.S. District Court of the Virgin Islands that was rendered in 2011. The decision can be found in Volume 775, page 765, of the *Federal Supplement*, Second Series (F.Supp.2d), published by West Publishing Company.

29. (LO 2) See Concept Summary 2.2.

a. None.

b. USTC.

c. USTC.

d. USTC.

e. TCM.

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

31. (LO 1, 2)

a. Yes. Exhibit 2.3.

b. No. Not published there. Concept Summary 2.2.

c. No. Published by private publishers and the IRS. Exhibit 2.3.

d. Yes. Exhibit 2.3.

e. Yes. Exhibit 2.3.

f. No. Concept Summary 2.2.

g. Yes. Exhibit 2.3.

h. No. Concept Summary 2.2.

32. (LO 3) After understanding the relevant facts and the accounting rules related to qualified stock options:

- Yvonne can begin with the index volumes of the available tax services: RIA, CCH, or BNA Portfolios.
- A key word search on an online service should be helpful—Thomson Reuters *Checkpoint*, CCH *IntelliConnect*, LexisNexis, or Westlaw (or WestlawNext).
- Yvonne may browse through IRS publications (available on the IRS website).
- Yvonne could consult CCH's *Federal Tax Articles* to locate current appropriate articles written about qualified stock options. Thomson Reuters publishes the *Index to Federal Tax Articles* that is organized using RIA's paragraph index system.
- Additional information can be found on the internet.

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33. (LO 4) The current Code can be found in various places. Several of the major tax services publish paperback editions of the Code (and Regulations). These editions are usually revised twice each year. Further, the text of the Code may be found in the major tax services and as Title 26 of the U.S. Code. The Code also may be found on the Web.

34. (LO 2, 3, 4) The best means of locating tax articles pertinent to your problem is through Commerce Clearing House's *Federal Tax Articles*. This multivolume service includes a subject index, a Code section number index, and an author's index. Another is the *Index to Federal Tax Articles* (published by Thomson Reuters). Both of these indexes are updated periodically but are available only in print form.

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

35. (LO 6) The primary purpose of effective tax planning is to maximize the taxpayer's after-tax wealth. This process can entail an avoidance, a reduction, or a postponement of the tax until the future.

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

    There is nothing illegal or immoral about tax avoidance. But it is important to understand the difference between tax avoidance and tax evasion. A citizen has every legal right to arrange his or her affairs to keep the attendant taxes as low as possible. One is required to pay no more taxes than the law demands.

36. (LO 7) Task-based simulations on the CPA exam are case studies that allow candidates to demonstrate their knowledge and skills by generating responses to questions rather than simply selecting an answer. They typically require candidates to use spreadsheets and/or to research authoritative literature provided in the CPA exam (e.g., Internal Revenue Code, Treasury Department Regulations, IRS publications, and Federal tax forms). In addition, the task-based simulations provide increased background material and data that require candidates to determine what information is or is not relevant to the questions.

PROBLEMS

37. (LO 1)
    b. Subchapter C; see discussion on p. 2-5.

38. (LO 1, 2)
    a. Individual tax rates.
    b. Corporate tax rates.
    c. Definition of gross income.
    d. Definition of adjusted gross income.
    e. Trade or business deductions.
    f. Production of income expenses.
    g. Nondeductibility of personal expenses.

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39. (LO 1, 2)

a. In 2021, the Chair was Richard Neal. He represents the 1st district from the state of Massachusetts.

b. In 2021, there were 43 members (25 Democratic; 18 Republican).

c. The Committee on Ways and Means is the oldest committee of the United States Congress, and is the chief tax-writing committee in the House of Representatives. The Committee derives a large share of its jurisdiction from Article I, Section VII of the U.S. Constitution which declares, "All Bills for raising Revenue shall originate in the House of Representatives." First established as a select committee on July 24, 1789, it was discharged less than two months later. The committee was reappointed from the first session of the Fourth Congress in 1795 and was formally listed as a standing committee in the House Rules on January 7, 1802. Until 1865, the jurisdiction of the committee (referred to as the Committee of Ways and Means before 1880) included the critically important areas of revenue, appropriations, and banking. Since 1865, the committee has continued to exercise jurisdiction over revenue and related issues such as tariffs, reciprocal trade agreements, and the bonded debt of the United States. Revenue-related aspects of the Social Security system, Medicare, and social services programs also come within the scope of the Committee on Ways and Means.

d. In 2021, there were six subcommittees: Health, Oversight, Social Security, Select Revenue Measures, Trade, and Worker and Family Support.

40. (LO 1)

b. *Internal Revenue Bulletin*; see Exhibit 2.3.

41. (LO 1)

d. Temporary Regulations; see Exhibit 2.3.

42. (LO 1, 4)

(1) Code Section.

(2) Legislative Regulation.

(3) Recent Temporary Regulation.

(4) Interpretive Regulation.

(5) Revenue Ruling.

(6) Proposed Regulation.

(7) Letter Ruling.

43. (LO 1, 2)

a. Provides various prescribed interest rates for Federal income tax purposes for the month of January 2021. The ruling includes short-term, mid-term, and long-term applicable Federal rates (AFR) for January 2021.

b. Identifies the proper MACRS class (tax depreciation) for the depreciation of tangible assets that are used in converting corn to fuel grade ethanol.

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c. Discusses the tax treatment of allowances and reimbursements paid to a member of the U.S. House of Representatives. These include allowances for hiring clerks; obtaining office supplies and equipment, telephones, and computers and related services; renting a home district office, communicating with constituents, and traveling (among others).

d. Discusses the tax treatment of ATM fees incurred by taxpayers when they obtain a cash advance from an ATM.

44. (LO 1, 2)
a. Retroactive application of 50% "bonus" depreciation in 2014.

b. Limitation of depreciation for autos placed in service in 2019.

c. Casualty loss caused by deterioration of concrete foundations.

d. Revisions to certain real property depreciation tables.

45. (LO 1, 2) In Announcement 2020-1 (2020–5 I.R.B. 401), the IRS indicated that it had revoked the tax-exempt status of 44 different organizations. As of January 27, 2020, these organizations no longer qualify as tax-exempt organizations [under § 501(c)(3) and § 170(c)(2)].

46. (LO 1, 2) In PLR 201450001, the IRS ruled on the appropriate cost recovery period for outdoor digital LED advertising displays following an election under the involuntary conversion rules to treat the displays as real property.

47. (LO 1, 2)
a. Rev.Rul. 2019–22 (2019–14 I.R.B. 931).

b. The phaseout of the electric vehicle credit for General Motors.

c. If a new qualified plug-in electric drive motor vehicle sold by General Motors, LLC, is purchased for use or lease on or after April 1, 2019, the allowable credit is as follows:

(1) For vehicles purchased for use or lease on or after April 1, 2019, and on or before September 30, 2019, the credit is 50 percent of the otherwise allowable amount determined under § 30D(b);
(2) For vehicles purchased for use or lease on or after October 1, 2019, and on or before March 31, 2020, the credit is 25 percent of the otherwise allowable amount determined under § 30D(b);
(3) For vehicles purchased for use or lease on or after April 1, 2020, no credit is allowable.

48. (LO 1, 2) Taxpayers who claim an itemized deduction for the interest they pay on adjustable-rate mortgages and receive a refund from their mortgage company in a following year must include the refund as income. Taxpayers who claimed the standard deduction rather than an actual interest deduction are *not* required to include the refund in income (Announcement 92–172).

49. (LO 1, 2) Loan origination fees ("points") paid by the buyer with regard to VA and FHA loans may be treated as deductible points in the year of the sale (Rev.Proc. 92–12 and Rev.Proc. 94–27).

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50. (LO 2) The IRS maintains a website on virtual currency:

irs.gov/businesses/small-businesses-self-employed/virtual-currencies

In addition, Notice 2014–21 (2014–21 I.R.B. 938) explains how existing tax principles apply to transactions involving virtual currency. In Notice 2014–21, the IRS concludes that virtual currency is property and that sales or exchanges of virtual currency result in capital gains or losses. Code § 1031 provides information on the tax consequences of like-kind exchanges. Currently, § 1031 only applies to real property (e.g., land and buildings). As a result, an exchange of cryptocurrencies will result in a capital gain or loss; § 1031 is not available.

Notice 2014–21 also discusses the tax implications of mining a cryptocurrency (see Q-8, Q-9, and Q-10). When a taxpayer successfully "mines" virtual currency, the fair market value of the virtual currency as of the date of receipt is includible in gross income. The question then becomes whether the mining is a "hobby" or a "trade or business." The IRS references a news release from April 2007 (FS-2007-18) to help make this determination.

If a taxpayer's "mining" of virtual currency constitutes a trade or business and the "mining" activity is not undertaken by the taxpayer as an employee, the net earnings from self-employment (generally, gross income derived from carrying on a trade or business less allowable deductions) resulting from those activities constitute self-employment income and are subject to the self-employment tax. Consequently, the fair market value of virtual currency received for services performed as an independent contractor, measured in U.S. dollars as of the date of receipt, constitutes self-employment income and is subject to the self-employment tax.

51. (LO 2) A letter ruling is a written determination issued by the IRS Office of Chief Counsel in response to a taxpayer's written request, prior to the filing of a tax return (or other report required by law).

Rev.Proc. 2022–1 (2022–1 I.R.B. 1) provides significant detail regarding this process (the revenue procedure is more than 115 pages long). The IRS will not provide rulings on certain issues [see, for example, Rev.Proc. 2022–3 (2022–1 I.R.B. 144)], and any ruling applies only to that taxpayer. In addition, any ruling can be revoked by the IRS. Rev.Proc. 2022–1 (which is updated annually) provides a schedule of user fees, a sample format for a letter ruling request, and a checklist for the request. Generally, the user fee is not refundable and the user fee can range from $30,000 to $38,000. Of course, the practitioner's fee also must be factored into this decision. These costs mean that only those tax issues with significant tax costs are considered for a private letter ruling request.

52. (LO 2) The cost of the football tickets for Alejandra and Zach is considered to be an entertainment expense and is not deductible (see § 274). But the cost of the lunch is not considered entertainment because it was purchased separately. As a result, it is deductible as a meal expense (see Reg. § 1.274–12 and Notice 2018–76). The meal expense is subject to the 50% limitation (see § 274 and Reg. § 1.274–11); the alumni tent is not a "restaurant," so the 50% limitation applies in 2021 and 2022.

53. (LO 4)
a. P.

b. P.

c. P.

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d. S.

e. P.

f. S.

g. P. Valid for three years.

h. P.

i. N.

j. P.

k. P.

54. (LO 1, 2) See Concept Summary 2.2.

a. CCH.

b. RIA.

c. U.S.

d. CCH.

e. U.S.

f. RIA.

g. W.

h. W.

i. W.

j. W.

k. U.S.

l. U.S.

55. (LO 1, 2)

a. U.S. Supreme Court.

b. 1955.

c. This is a "landmark case" where the Supreme Court defined the term *income*. Two cases with different facts but the same issue were consolidated by the Supreme Court in this opinion. The common question is whether money received as exemplary damages for fraud or as the punitive two-thirds portion of a treble-damage antitrust recovery must be reported by a taxpayer as gross income. The Supreme Court held that income is realized whenever there are "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have compete dominion." So here, both taxpayers had income. And because Congress had not provided an exclusion for these income items, both also were included in gross income.

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56. (LO 1, 2)

a. The court addressed whether an interest the taxpayer held in various jet aircraft constituted a trade or business under § 162 (with a net loss allowed in determining the taxpayer's taxable income) or a hobby under § 183 (with deductions limited to any income generated by the activity). The taxpayer asked the Tax Court to shift the burden of proof to the IRS (from the taxpayer) and asked the Court to excuse the substantial underpayment penalty due to reliance on professional advisers.

b. The Tax Court held that the activity did not rise to the level of profit motive to permit deductions (i.e., it was a hobby under § 183). The burden of proof was not shifted to the IRS (so it was the taxpayer's duty to provide evidence of profit motive), and the substantial underpayment penalty that was assessed as reliance on professionals was not supported by evidence.

57. (LO 1, 2)

a. *Speer v. Commissioner*.

b. U.S. Tax Court.

c. 2015.

d. The court addressed whether unused vacation and sick pay paid to the taxpayer upon retirement was includible as gross income. The taxpayer argued that some of the vacation and sick pay was accrued while the taxpayer was on temporary disability, and so some of the pay should be excluded from income. The Tax Court held that since the leave payments were not paid as workers' compensation (i.e., for personal injuries or sickness), the payments were not excludible from income.

58. (LO 6)

a. E.

b. E.

c. A.

d. A.

e. A.

RESEARCH PROBLEMS

1. a. *Higgens v. Comm.*, 312 U.S. 212 (1941).

b. *Talen v. U.S.*, 355 F.Supp.2d 22 (D.Ct. D.C., D.D.C., 2004).

c. Rev.Rul. 2008–18, 2008–13 I.R.B. 674.

d. *Pahl v. Comm.*, 150 F.3d 1124 (CA–9, 1998).

e. *Veterinary Surgical Consultants PC*, 117 T.C. 141 (2001).

f. *Yeagle Drywall Co.*, T.C. Memo. 2001–284.

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

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

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

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

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

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

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

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

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

Research Problems 5 and 6

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.

5. (1) A Google search will likely produce a variety of links, including one to Cornell University Law School's Legal Information Institute (**law.cornell.edu/uscode/text/26/61**). This section defines gross income broadly. In addition to the 14 items specifically listed as income, § 61 directs the reader to other IRC sections and indicates that the list of income items is not all-inclusive. In general, the IRC takes a broad view of income; everything is income unless an IRC section specifies that the amount is not income.

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(2) To find the case, go to the U.S. Tax Court website and on the "Orders & Opinions" drop down menu, click on Opinions Search. Enter the name Mark Spitz in the "Case Name Keyword" field and click on the Search button.

a. The tax years are 2001 and 2002, as indicated in the first sentence of the case, not 2006, the year in the citation, which is the year the case was decided.

b. As noted above, 2006.

c. The court decided in favor of the IRS.

d. At the end of the decision, the penalty in § 6662 is discussed. This section imposes a 20% accuracy-related penalty on any portion of a tax liability underpayment (the situation in which Mr. Spitz found himself) attributable to a substantial understatement of income tax. Mr. Spitz was found not liable for the penalty because the court indicated that he was unsophisticated in tax law and had relied on a competent adviser to prepare his return.

6. a. From the "Orders & Opinions" drop down menu, click on Opinions Search. On the "Opinions Search" tab, review the "Opinion Type" choices.

b./c. From the "Orders & Opinions" drop down menu, click on Opinions Search. On the "Opinions Search" tab, select the appropriate opinion type, and enter a common last name in the "Case Name Keyword" bar.

d. From the "Rules & Guidance" drop down menu, click on Tax Court Rules.

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

SOLUTION TO ETHICS & EQUITY FEATURE

Reporting Tax Fraud (p. 2-7). A survey given in 2014 by the IRS Oversight Board indicated that 86 percent of Americans believe that it is unacceptable to cheat on their taxes. On the other hand, that same survey indicated that 11 percent of taxpayers said that some cheating on their taxes was acceptable.

In October 2019, the IRS released its latest assessment of the tax gap (IR-2019-159). The IRS estimates that the gross average tax gap for the years 2011, 2012, and 2013 is about $441 billion per year. Voluntary payments or IRS administrative/enforcement efforts were $60 billion, resulting in a net tax gap of approximately $381 billion. These figures translate to around 83.6% of taxes being paid voluntarily and on time. See also **irs.gov/pub/irs-pdf/p1415.pdf** and **irs.gov/pub/irs-pdf/p5365.pdf**.

In May 2021, the Department of the Treasury estimated the 2019 gross tax gap to be around $630 billion, with more than $3.6 trillion of taxes owed but only about $3 trillion paid voluntarily. Enforcement activities and late penalties brought in $76 billion of additional revenues. The Treasury Department estimated the voluntary compliance rate (after enforcement activities) to be about 84.8% (roughly the same as in the 2019 IRS study). The Treasury report is at **home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf**. The Treasury Department attributes the tax gap to areas where there is limited information reporting (rental income and proprietorship income), sophisticated (and complex) pass-through entity structures, and offshore income. See also the Committee for a Responsible Federal Government blog on the tax gap (**crfb.org/blogs/primer-understanding-tax-gap**).

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Instructor's Guide

Young/Nellen/Maloney/Persellin/Cuccia/Lassar/Cripe, SWFT 2023 Volume 3: Comprehensive Volume, 9780357719688; Chapter 2: Working with the Tax Law

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Chapter Objectives

The following objectives are addressed in this chapter:

2.1 Distinguish between the statutory, administrative, and judicial sources of the tax law and understand the purpose of each source.

2.2 Locate and work with the appropriate tax law sources.

2.3 Develop an awareness of tax research tools.

2.4 Describe the tax research process.

2.5 Communicate the results of the tax research process in a client letter and a tax file memorandum.

2.6 Apply tax research techniques and planning procedures.

2.7 Be aware of taxation on the CPA examination.

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Chapter Outline

In the outline below, each element includes references (in parentheses) to related content. "CO CH.##" refers to the chapter objective; "PPT Slide #" refers to the slide number in the PowerPoint deck for this chapter (provided in the PowerPoints section of the Instructor Resource Center); and, as applicable for each discipline, accreditation or certification standards ("BL 1.3.3"). Introduce the chapter and use the Ice Breaker in the PPT if desired, and if one is provided for this chapter. Review learning objectives for Chapter 2. (PPT Slides 2–3).

I. Tax Law Sources (2.1, PPT Slides 6–35)

a. Statutory Sources of the Tax Law

i. Statutory sources of law include the Constitution (Article I, Sections 7, 8, and 10), the Internal Revenue Code, and tax treaties (agreements between countries to mitigate the double taxation of taxpayers subject to the tax laws of those countries).

ii. Origin of the Internal Revenue Code.

1. Known as the Internal Revenue Code of 1939, the codification arranged all Federal tax provisions in a logical sequence and placed them in a separate part of the Federal statutes.
2. A further rearrangement took place in 1954 and resulted in the Internal Revenue Code of 1954, which continued in effect until 1986, when it was replaced by the Internal Revenue Code of 1986.
3. Although Congress did not recodify the law in the Tax Reform Act (TRA) of 1986, the magnitude of the changes made by TRA of 1986 did provide some rationale for renaming the Federal tax law the Internal Revenue Code of 1986.

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iii. The Legislative Process.
1. Exhibit 2.1 in the text illustrates the legislative process for enacting changes to the Internal Revenue Code of 1986.
2. Tax legislation normally originates in the House Ways and Means Committee of the House of Representatives because the U.S. Constitution mandates that revenue raising bills begin in the House. A tax bill might originate in the Senate when it is attached to other legislative proposals.
3. Tax legislation is referred from the Senate Finance Committee to the entire Senate. If the House and Senate tax bills disagree, the Joint Conference Committee resolves the differences. (See Exhibit 2.2 in the text.)
4. The Committee Reports explain the provisions of the proposed legislation and are a valuable source for ascertaining the intent of Congress. What Congress had in mind when it considered and enacted tax legislation is, of course, the key to interpreting the legislation by taxpayers, the IRS, and the courts.

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

v. Citing the Code. See the description in the text for the form used to reference Code Sections.

b. Administrative Sources of the Tax Law (See Exhibit 2.3 in the text.)
i. Treasury Department Regulations. The Treasury Department under § 7805(a) has a duty to issue rules and regulations to explain and interpret the Code.
1. Regulations, which carry considerable authority as the official interpretation of tax law, may be issued in proposed, temporary, or final form.
(a) New Regulations and changes to existing Regulations are usually issued in proposed form before they are finalized. The interval between the proposal of a Regulation and its finalization permits taxpayers and other interested parties to comment on the propriety of the proposal. Proposed Regulations carry little weight in the litigation process.
(b) Final Regulations have the force and effect of law. Final Regulations are issued as Treasury Decisions (TDs).
(c) Temporary Regulations are issued where immediate guidance is important.

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2. Proposed, Temporary, and Final Regulations are published in the *Federal Register*, in the *Internal Revenue Bulletin*, and by major tax services.
3. Regulations may also be classified as legislative, interpretive, or procedural.

ii. Revenue Rulings, Revenue Procedures, and Notices.
1. Revenue Rulings are official pronouncements of the National Office of the IRS and provide guidance to both IRS personnel and taxpayers in handling routine tax matters. They usually deal with more restricted problems than Regulations and do not carry the same legal force and effect as Regulations.
2. Revenue Procedures are issued in the same manner as Revenue Rulings, but they deal with the internal management practices and procedures of the IRS.
3. Notices are issued when immediate guidance is needed by taxpayers and tax practitioners. Typically, this guidance is transitional while the IRS works on permanent guidance on the particular topic. Notice 2021–49 provides guidance to employers claiming the employee retention credit during the last six months of 2021; the guidance reflects changes made by the American Rescue Plan Act of 2021.
4. Revenue Rulings, Revenue Procedures, and Notices serve an important function by providing guidance to IRS personnel and taxpayers in handling routine tax matters.
   (a) They generally apply retroactively and are binding on the IRS until revoked or modified by subsequent rulings or procedures, Regulations, legislation, or court decisions.
   (b) They are published weekly by the U.S. Government in the *Internal Revenue Bulletin* (I.R.B.). *Internal Revenue Bulletins* can be found at the IRS website: irs.gov/irb.

iii. Letter Rulings. A letter ruling is a statement issued by the National Office of the IRS in response to a taxpayer's request, which applies the tax law to a proposed transaction. Revenue rulings can result from a taxpayer request for a letter ruling if the holding affects many taxpayers. The IRS issues more than 2,500 letter rulings each year.

iv. Other Administrative Pronouncements.
1. *Treasury Decisions* (TDs) are issued by the Treasury Department to announce new Regulations, amend or change existing Regulations, or announce the position of the Government on selected court decisions. TDs are published in the *Internal Revenue Bulletin*.
2. The IRS also publishes other administrative communications on its website, including Announcements, IRs (News Releases), Internal

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Legal Memoranda (ILMs), Chief Counsel Advice (CCA), and Chief Counsel Notices (CCN).

3. A determination letter is a statement issued by the Area Director in response to a taxpayer and provides guidance on the application of the tax law.
4. A variety of internal memoranda that constitute the working law of the IRS also are released. These Chief Counsel Advice (CCAs), Technical Advice Memoranda (TAMs), Internal Legal Memoranda (ILMs) are not officially published, and the IRS indicates that they may not be cited as precedents by taxpayers.
   (a) Technical Advice Memoranda (TAMs) are furnished by the National Office on a weekly basis. TAMs deal with completed (rather than proposed) transactions. TAMs are issued by the National Office of the IRS in response to questions raised by taxpayers or IRS field personnel during audits.
   (b) The Office of Chief Counsel prepares Chief Counsel Advice (CCAs) and Chief Counsel Notices (CCNs) to help IRS employees. These are issued in response to requests for advice, guidance, and analysis on difficult or significant tax issues and are not binding on either the taxpayer to whom they pertain or the IRS.
   (c) Another form of field guidance are Technical Expedited Advice Memoranda (TEAMs). The purpose of TEAMs is to expedite legal guidance to field agents as disputes are developing.

c. Judicial Sources of the Tax Law
   i. Five Federal courts have jurisdiction over tax disputes between the IRS and taxpayers: the U.S. Tax Court, the U.S. District Court, the U.S. Court of Federal Claims, the U.S. Court of Appeals, and the U.S. Supreme Court.
   ii. The Judicial Process in General. After a taxpayer has exhausted the remedies available within the IRS, the dispute can be taken to the Federal courts. The trial and appellate court system for Federal tax litigation is illustrated in Exhibit 2.4 in the text.
      1. A trial court, also known as a court of original jurisdiction, initially hears the case. Appeals (either by the taxpayer or the IRS) are heard by the appropriate appellate court. A taxpayer has a choice of three trial courts: a U.S. District Court, the U.S. Court of Federal Claims, or the U.S. Tax Court.
      2. The U.S. Tax Court contains a Small Cases Division that only hears cases involving amounts of $50,000 or less. No appeal is available. The broken line between the U.S. Tax Court and the Small Cases Division in Exhibit 2.4 in the text indicates that there is no appeal from the Small Cases Division.

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(a) This court only hears cases involving disputed amounts of $50,000 or less.
(b) Informal proceedings.
(1) No requirement for the taxpayer to be represented by a lawyer or other tax adviser.
(2) Special trial judges, rather than Tax Court judges, often preside over the proceedings.
(3) Decisions are not precedent for any other court and are not reviewable by any higher court.

3. American law, following English common law, is frequently created by judicial decisions. Under the doctrine of *stare decisis*, each case has precedential value for future cases with the same controlling set of facts.
4. At the trial court level, a taxpayer is normally the plaintiff (or petitioner) and the Government is the defendant (or respondent). If the taxpayer wins and the Government appeals, the Government becomes the petitioner (or appellant), and the taxpayer becomes the respondent.

iii. Trial Courts. (See Concept Summary 2.1 in the text for a summary of various attributes of the Federal trial courts.) The differences among the various trial courts can be summarized as follows:

- Number of courts.
- Number of judges.
- Location.
- Jurisdiction of the Tax Court and District Courts.
- Jurisdiction of the Court of Federal Claims.
- Jury trial.
- Payment of deficiency.
- Appeals.
- Bankruptcy.
- Gray areas.

iv. Appellate Courts. A trial court decision can be appealed to the appropriate Circuit Court of Appeals by the losing party. The 11 geographic circuits, the circuit for the District of Columbia, and the Federal Circuit appear in Exhibit 2.5 in the text.

1. Generally, a three-judge panel hears a Court of Appeals case, but occasionally the full court decides more controversial cases.
2. If the Government loses at the trial court level (District Court, Tax Court, or Court of Federal Claims), it may decide not to appeal. However, the fact that the IRS does not appeal does not mean that the IRS agrees with the result.
3. The Federal Circuit provides the taxpayer with an alternative forum. When a particular Circuit Court of Appeals has issued an adverse

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decision in a similar case, the taxpayer may prefer the Court of Federal Claims route, because any appeal is to the Federal Circuit.

v. The Appellate Process. The role of the appellate court usually is limited to a review of whether the trial court applied the proper law in arriving at its decision.
   1. Both the Code and the Supreme Court indicate that Federal appellate courts are bound by findings of facts unless they are clearly erroneous.
   2. The appellate court may approve (affirm) or disapprove (reverse) the lower court's finding, or it may send the case back for further consideration (remand).
   3. Appellate Precedents and the Tax Court. District Courts, the Tax Court, and the Court of Federal Claims must abide by the precedents set by a Court of Appeals jurisdiction.
   4. All courts must follow the decision of the U.S. Supreme Court.
   5. Since the *Golsen* decision [*Jack E. Golsen*, 54 T.C. 742 (1970)], the Tax Court decides a case as it believes the law should be applied only if the Court of Appeals has not yet ruled on the issue.
   6. Appeal to the U.S. Supreme Court. The U.S. Supreme Court grants certiorari to resolve a conflict among the Courts of Appeals or where the tax issue is extremely important. The granting of a Writ of Certiorari indicates that at least four of the nine members of the Supreme Court believe that the issue is of sufficient importance to be heard by the full Court.

vi. Judicial Citations. (2.2, PPT Slides 36–43) Judicial citations usually follow a standard pattern: case name, volume number, reporter series, page or paragraph number, court, and year of the decision (see Concept Summary 2.2 in the text).
   1. Judicial Citations—The U.S. Tax Court. The U.S. Tax Court issues two types of decisions: Regular and Memorandum, based on the Chief Judge's determination. They differ in both substance and form.
      (a) Memorandum decisions deal with cases that involve only the application of established principles of law.
      (b) Regular decisions involve novel issues not previously resolved by the Tax Court.
      (c) In actual practice, both Regular and Memorandum represent the position of the Tax Court and, as such, can be relied on.
      (d) Regular Tax Court decisions are published by the U.S. Government Printing Office in a series entitled *Tax Court of the United States Reports*. Memorandum decisions are published on the U.S. Tax Court website (ustaxcourt.gov). Memorandum decisions, although available on the U.S. Tax Court website, are not published by the U.S. Government.

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(e) If the IRS loses a decision, it may indicate whether it agrees or disagrees with the results reached by the court by publishing an acquiescence ("A" or "*Acq.*") or nonacquiescence ("NA" or "*Nonacq.*"), respectively. The acquiescence or nonacquiescence is published in the *Internal Revenue Bulletin* (and an *Action on Decision* is issued).

2. Judicial Citations—The U.S. District Court, Court of Federal Claims, and Courts of Appeals. Decisions dealing with Federal tax matters are reported in both the CCH *U.S. Tax Cases* (USTC) and the RIA *American Federal Tax Reports* (AFTR) series. U.S. District Court decisions, dealing with both tax and nontax issues, also are published by West in its *Federal Supplement Second Series*.
3. Judicial Citations—The U.S. Supreme Court. Decisions are published by CCH in the USTCs and by RIA in the AFTRs. The U.S. Government Printing Office also publishes these decisions in the *United States Supreme Court Reports* (U.S.), as does West in its *Supreme Court Reporter* (S.Ct.), and the Lawyer's Co-operative Publishing Company in its *United States Reports, Lawyer's Edition* (L.Ed.).

d. Other Sources of the Tax Law
   i. Tax Treaties. Tax legislation provided that neither a tax law nor a tax treaty takes general precedence. If there is a conflict between the Code and a treaty, the most recent item takes precedence.
   ii. Tax Periodicals. The use of tax periodicals can shorten the research time needed to resolve a tax issue.

II. Working with the Tax Law—Tax Research Tools (2.3, PPT Slides 44–49)

a. Commercial Tax Services
   i. In the past, commercial tax services could be classified as annotated or topical. However, as tax research has become electronic, this classification system is no longer appropriate. Some of the available commercial tax services include the following:
      1. *CCH IntelliConnect* and CCH A*nswerConnect*, CCH/Wolters Kluwer. Includes the *Standard Federal Tax Reporter* (along with other CCH materials).
      2. Thomson Reuters *Checkpoint*, Research Institute of America. Includes RIA's *Federal Tax Coordinator 2d* and *United States Tax Reporter*.
      3. *Practical Tax Expert*, CCH/Wolters Kluwer.
      4. *Tax Management Portfolios*, Bloomberg BNA.
      5. Parker Tax Pro *Library*.
      6. *Mertens Law of Federal Income Taxation*, Thomson Reuters.

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7. Thomson Reuters *Westlaw* and *WestlawNext*—compilations include access to *Tax Management Portfolios*, *Federal Tax Coordinator 2d*, and *Mertens*.
8. LexisNexis *TaxCenter*—a compilation of primary sources and various materials taken from CCH, Matthew Bender, Kleinrock, and Bloomberg BNA.

b. Using Electronic (Online) Tax Services
   i. A competent tax professional must become familiar and proficient with electronic research services and be able to use them to complete research projects efficiently.
   ii. Following certain general procedures can simplify the research process. The following suggestions may be helpful:
      1. Choose keywords for the search carefully.
      2. Take advantage of connectors.
      3. Be selective in choosing the data to search.
      4. Use a table of contents, index, or citation when appropriate.
      5. Always check for current developments.

c. Noncommercial Electronic (Online) Tax Services
   i. The internet provides a wealth of tax information in several popular forms, sometimes at no cost to the researcher.
   ii. A tax professional can access a significant amount of information that can assist in the research process.
      1. Websites are provided by accounting and consulting firms, publishers, tax academics, libraries, and governmental bodies as a means of making information widely available. One of the best sites available to the tax professional is the Internal Revenue Service's home page, illustrated in Exhibit 2.6 in the text.
      2. Exhibit 2.7 in the text lists some of the websites that may be most useful to tax researchers.
      3. 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.

III. Working with the Tax Law—Tax Research (2.4, PPT Slides 50–56)

   i. Tax research is the process of finding a competent and professional conclusion to a tax problem. The problem may originate either from completed or proposed transactions.
   ii. Tax research involves the following steps (illustrated in Exhibit 2.8 in the text):
      1. Identifying and refining the problem.
      2. Locating the appropriate tax law sources.
      3. Assessing the validity of the tax law sources.

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4. Arriving at the solution or at alternative solutions (including consideration of nontax factors).
5. Effectively communicating the solution to the taxpayer.
6. Updating the solution in light of new developments.

a. Identifying the Problem
   i. Problem identification must start with a compilation of the relevant facts involved. In other words, all of the facts that may have a bearing on the problem must be gathered.
b. Refining the Problem
   i. Use new facts to refine the tax problem.
c. Locating the Appropriate Tax Law Sources
   i. Once the problem is clearly defined, most tax research begins with a keyword search using an electronic tax service.
d. Assessing the Validity of Tax Law Sources
   i. Once a source has been located, the next step is to assess it in light of the problem at hand. Proper assessment involves careful interpretation of the tax law with consideration given to its relevance and validity.
   ii. Interpreting the Internal Revenue Code. This is the greatest challenge for the IRS. The language of the Code is difficult to comprehend fully. If an answer is not in the Code, it may be necessary to look to other tax law, including Regulations and judicial decisions.
   iii. Assessing the Validity of a Treasury Regulation.
      1. Give the Code and related Regulations equal weight when dealing with taxpayers and their representatives.
      2. Proposed Regulations are not binding.
      3. The burden of proof is on the taxpayer.
      4. If the taxpayer loses a challenge, then a 20% accuracy-related penalty may apply.
      5. Final Regulations can be classified as procedural, interpretive, or legislative. Procedural Regulations are housekeeping-type instructions indicating information that taxpayers should provide the IRS.
      6. Interpretive Regulations are almost impossible to overturn.
      7. In some Code Sections, Congress has given the Treasury Secretary the authority to prescribe Regulations to carry out the details of administration. Regulations issued under this type of authority possess the force and effect of law and are often called legislative Regulations.
      8. Courts tend to apply a legislative reenactment doctrine.
   iv. Assessing the Validity of Other Administrative Sources of the Tax Law. Revenue Rulings issued by the IRS carry less weight than Treasury Department Regulations. Revenue Rulings are important, however, in that they reflect the position of the IRS on tax matters.

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v. Assessing the Validity of Judicial Sources of the Tax Law. How much reliance can be placed on a particular decision depends on the following variables:
   1. The level of court. The higher the level of the court that issued a decision, the greater the weight accorded to that decision.
   2. Residence of the taxpayer. More reliance is placed on decisions of courts that have jurisdiction in the area where the taxpayer's legal residence is located.
   3. Regular or Memorandum decision. A Tax Court Regular decision carries more weight than a Memorandum decision because the Tax Court does not consider Memorandum decisions to be binding precedents.
   4. Circuit Court decision. A Circuit Court decision heard *en banc* (all of the judges participate) carries more weight than a normal Circuit Court case.
   5. Other courts' support. A decision that is supported by cases from other courts carries more weight than a decision that is not supported by other cases.
   6. Status on appeal. The weight of a decision also can be affected by its status on appeal.

   In connection with the last three variables, the use of a citator is invaluable to tax research. A citator provides the history of a case, including the authority relied on in reaching the result.

vi. Assessing the Validity of Other Sources.
   1. Primary sources of tax law include the Constitution, legislative history materials, statutes, treaties, Treasury Regulations, IRS pronouncements, and judicial decisions.
   2. Reference to secondary sources such as legal periodicals, treatises, legal opinions, IRS publications, and other materials can be useful. In general, secondary sources are not authority.
   3. For purposes of the accuracy-related penalty in § 6662, the IRS expands the list of substantial authority to include a number of non-primary sources.
   4. A letter ruling or determination letter is substantial authority only for the taxpayer to whom it is issued, except for the accuracy-related penalty.
   5. Once major tax legislation is completed, the staff of the Joint Committee on Taxation (in consultation with the staffs of the House Ways and Means and Senate Finance Committees) often prepares a General Explanation of the Act, commonly known as the Bluebook.

e. Arriving at the Solution or at Alternative Solutions
   i. Discuss possible solutions to The Big Picture questions.

f. Communicating Tax Research (2.5, PPT Slides 50–56)

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i. A good tax research communication should tell the audience what was researched, the results of the research, and the justification for the recommendation made. It should contain the following elements:
   - A clear statement of the issue.
   - A short review of the facts that raised the issue.
   - A review of the relevant tax law sources.
   - Any assumptions made in arriving at the solution.
   - The solution recommended and the logic or reasoning supporting it.
   - The references consulted in the research process.

ii. Exhibits 2.9 and 2.10 in the text present the tax file memorandum (internal to the firm) and the client letter associated with the facts of The Big Picture.

IV. Working with the Tax Law—Tax Planning (2.6, PPT Slides 57–58)

i. Tax research and tax planning are inseparable.
   1. The primary purpose of effective tax planning is to maximize the taxpayer's after-tax wealth.
   2. The secondary objective of effective tax planning is to reduce or defer the tax in the current tax year.

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

b. Components of Tax Planning
   i. The popular perception of tax planning often is restricted to the adage "defer income and accelerate deductions." Although this timing approach does hold true and is important, meaningful tax planning involves considerably more.
   ii. The key components of tax planning include the following:
      1. Avoid the recognition of income.
      2. Defer the recognition of income.
      3. Convert the classification of income.
      4. Choose the business entity with the desired tax attributes.
      5. Preserve formalities by generating and maintaining supporting documentation.
      6. Act in a manner consistent with the intended objective.

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

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1. Tax avoidance is merely tax minimization through legal techniques. In this sense, tax avoidance becomes the proper objective of all tax planning.
2. Evasion, although also aimed at the elimination or reduction of taxes, connotes the use of subterfuge and fraud as a means to an end.

d. Follow-Up Procedures
   i. Because tax planning usually involves a proposed transaction, being aware of if or when the law changes is critical to the tax planning process. A change in the tax law could alter the original conclusion. Additional research may be necessary to test the solution in light of current developments. (Refer to the broken lines at the right in Exhibit 2.8 in the text.)

e. Tax Planning
   i. Point out that throughout this text, each chapter concludes with observations on Tax Planning.

V. Taxation on the CPA Examination (2.7, PPT Slide 59)

   i. The 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).
   ii. The exam continues to evolve, placing less emphasis on remembering-and-understanding skills and greater focus on higher-level analysis and evaluation skills.
      1. Task-based simulations, a highly effective way to assess higher-order skills, are part of each section of the CPA exam.
      2. Total testing time is 16 hours (4 hours per section).
      3. 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.
      4. Using Bloom's taxonomy, the CPA exam tests remembering and understanding, application, analysis, and evaluation. In prior years, the CPA exam only tested for the first two of these items.

a. Preparation Blueprints
   i. To prepare for the CPA exam, candidates are able to use AICPA-developed Blueprints that replaced the Content Specification Outline (CSO) and Skill Specification Outline (SSO).
   ii. The Blueprints provide candidates with more detail about what to expect on the exam and contain about 570 representative tasks.
   iii. The Blueprints provide candidates with sample tasks that align with both the content and skill level at which the content will be tested.

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b. Regulation Section
    i. Taxation continues to be tested within the REG section of the CPA exam. Testing within REG is administered in five blocks called testlets, which feature multiple-choice questions (MCQs) and task-based simulations (TBSs).
    ii. There are five content areas in the REG section of the CPA exam:
        - Area 1: Ethics, professional responsibilities, and Federal tax procedures (weight: 10% to 20%).
        - Area 2: Business law (weight: 10% to 20%).
        - Area 3: Federal taxation of property transactions (weight: 12% to 22%).
        - Area 4: Federal taxation of individuals (weight: 15% to 25%).
        - Area 5: Federal taxation of entities (weight: 28% to 38%).
    iii. Candidates can learn more about the CPA examination at aicpa.org/resources/toolkit/cpa-exam.

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Discussion Questions

You can assign these questions several ways: in a discussion forum in your LMS; as whole-class discussions in person; or as a partner or group activity in class.

1. Discussion 1 (2.1, PPT Slides 6–35) Duration 15 minutes.
    a. A client who is a small independent oil and gas producer asks you to determine whether the business qualifies for percentage depletion. The client is worried that it may be classified as a refiner. Look up and read Code § 613A(d)(4), and prepare a response to your client.
        i. Answer: There are a number of limitations on the percentage of depletion deduction, but there is a limited exception for independent producers and royalty owners. This deduction, however, is not available for a taxpayer that is a retailer or refiner. But § 613A(d)(4) indicates that a percentage depletion deduction "shall not apply to the taxpayer for a taxable year if the average daily refinery runs of the taxpayer and such persons for the taxable year exceed 75,000 barrels." So as long as the independent producer is refining 75,000 barrels or less in a taxable year, the percentage depletion deduction will be available.
2. Discussion 2 (2.1, PPT Slides 6–35) Duration 15 minutes.
    a. Sanjay receives a settlement letter from the IRS after his discussion with an IRS appeals officer. He is not satisfied with the $101,000 settlement offer. Identify the relevant issues facing Sanjay if he chooses to contest the settlement offer.
        i. Answer: Sanjay must consider several factors in deciding whether to take the dispute to the judicial system:
            - How expensive will it be?
            - How much time will be consumed?
            - Does he have the temperament to engage in the battle?

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- What is the probability of winning?
- Once a decision is made to litigate the issue, the appropriate judicial forum must be selected.
- Tax Court judges have more expertise in tax matters.
- The tax deficiency need not be paid to litigate in the Tax Court. However, if Sanjay loses, interest must be paid on any unpaid deficiency.
- If a trial by jury is preferred, the U.S. District Court is the appropriate forum.
- The tax deficiency must be paid before litigating in the District Court or the Court of Federal Claims.
- If an appeal to the Federal Circuit is important, Sanjay should select the Court of Federal Claims.
- A survey of the decisions involving the issues in dispute is appropriate. If a particular court has taken an unfavorable position, that court should be avoided.

3. Discussion 3 (2.2, 2.3, and 2.4, PPT Slides 36–56) Duration 15 minutes.
   a. You inherit a tax problem that was researched five months ago. You believe the answer is correct, but you are unfamiliar with the general area. How would you find recent articles dealing with the subject area? How do you evaluate the reliability of the authority cited in the research report? How do you determine the latest developments pertaining to the research problem?
      i. Answer: The best means of locating tax articles pertinent to your problem is through Commerce Clearing House's *Federal Tax Articles*. This multivolume service includes a subject index, a Code Section number index, and an author's index. Another is the *Index to Federal Tax Articles* (published by Thomson Reuters). Both of these indexes are updated periodically but are available only in print form.

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

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