South-Western Federal Taxation 2016 Comprehensive 39th edition Hoffman 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.

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

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

4. (LO 2, 5)

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

March 25, 2015

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

Dear Mr. Bishop:

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

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

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

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

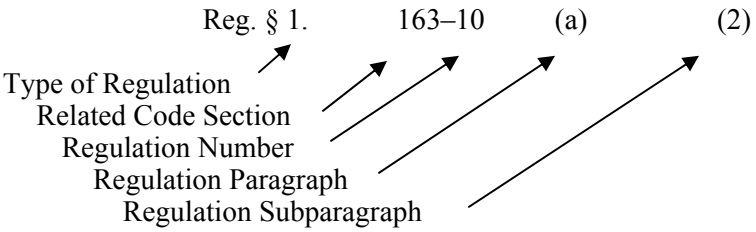
Sincerely,

Alice Hanks, CPA
Tax Partner

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5. (LO 1, 2) Income tax



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

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

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

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

(3) Revenue Ruling.

(4) Interpretive Regulation.

(5) Legislative Regulation.

(6) Internal Revenue Code.

8. (LO 1)

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

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

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

9. (LO 1, 5) TAX FILE MEMORANDUM

DATE: September 23, 2015

FROM: George Ames

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

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

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

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

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

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

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

12. (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.

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13. (LO 1, 5)

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

July 8, 2015

Mr. Eddy Falls
200 Mesa Drive
Tucson, AZ 85714

Dear Mr. Falls:

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

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

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

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

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

Sincerely,

Agnes Reynolds, CPA
Tax Partner

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

15. (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.

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c. Same as b. above.

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

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

17. (LO 1) See Exhibit 2.5.

a. 10th.

b. 8th.

c. 9th.

d. 5th.

e. 7th.

18. (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.

19. (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.

20. (LO 1, 4)

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

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

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

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

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

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

21. (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.

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

23. (LO 2)

a. Ninth Circuit Court of Appeals.

b. U.S. Tax Court.

c. U.S. Supreme Court.

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

e. Tax Court (memorandum decision).

f. Court of Claims.

g. Not a court decision.

h. District Court in New York.

i. Not a court decision.

24. (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.

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

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

25. (LO 2)
a. None.

b. USTC.

c. USTC.

d. USTC.

e. TCM.

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

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

- Yvonne may begin with the index volumes of the available tax services: RIA, CCH, BNA Portfolios, etc.
- A key word search on an online service could be helpful—WESTLAW, LEXIS, CCH, and Thomson Reuters Checkpoint.
- Yvonne may employ a key word search of a CD-ROM and browse through a tax service, IRS publications, etc. West Publishing, CCH, Kleinrock, and RIA offer CD-ROM products.
- Yvonne could consult CCH's Federal Tax Articles to locate current appropriate articles written about child support payments. RIA's Tax Service also has a topical "Index to Tax Articles" section that is organized using the RIA paragraph index system.
- Yvonne may consult The Accounting & Tax Index, which is available in three quarterly issues and a cumulative year-end volume covering all four quarters.
- Up-to-date information may be found on the Web. Various legal, accounting, and financial gateways can be found by clicking on highlighted words or phrases.

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

29. (LO 2, 4) The best means of locating tax articles pertinent to your problem is through Commerce Clearing House's *Federal Tax Articles*. This multivolume service includes a subject index, a Code

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section number index, and an author's index. Another is the Index to *Federal Tax Articles* (published by Warren, Gorham, and Lamont). Both of these indexes are updated periodically, but are available only in print form.

Court decisions and Revenue Rulings may be reviewed for reliability by using the *Federal Tax Citator* that is published by Research Institute of America. A citator provides the history of a case, including the authority relied on (e.g., other judicial decisions) in reaching the result. Reviewing the references listed in the citator discloses whether the decision was appealed and, if so, with what result (e.g., affirmed, reversed, or remanded). It also reveals other cases with the same or similar issues and how they were decided. Thus, a citator reflects on the validity of a case and may lead to other relevant judicial material. If one intends to rely on a judicial decision to any significant degree, "running" the case through a citator is imperative. The researcher must examine the cumulative paperback supplements to determine the current status of a case. Commerce Clearing House also publishes a *Citator*.

The Commerce Clearing House tax service contains a special volume that is devoted to current matters. RIA integrates the new developments into the body of the service throughout the year. Computer-assisted tax research might also be helpful.

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

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

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

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

PROBLEMS

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

33. (LO 1, 4)
    a. Code section.

    b. Legislative Regulation.

    c. Recent Temporary Regulation.

    d. Interpretive Regulation.

    e. Revenue Ruling.

    f. Letter Ruling.

    g. Proposed Regulation.

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

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

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

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RESEARCH PROBLEMS

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

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

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

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

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

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

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

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

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

   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 4 and 5

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

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

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

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

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

SOLUTION TO ETHICS & EQUITY FEATURE

Is It Ethical for the IRS to Ideologically Profile Nonprofit Advocacy Groups? (p. 2-7). For the IRS to have credibility with taxpayers, it must apply tax laws fairly and equitably without regard to ideology. Even the perception of inequity will cause problems (and it certainly appears that certain organizations were targeted for additional scrutiny).

In "What Enron and the IRS Have In Common," *Wall Street Journal*, June 6, 2013, p. A-17, Steven Law said that ethical breakdowns are rarely the result of a few isolated employees. Rather, he compares the IRS with Enron and believes that the problems at the IRS were "fostered by a culture that many powerful people in Washington helped create—and it will take time and hard-nosed action to eradicate it." The tone at the top is very important in any organization and even more so with an organization that is responsible for taxpayer compliance.

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NOTES

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