South Western Federal Taxation 2019 Individual Income Taxes 42nd edition Young Solutions Manual

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SWFT 2019 Individual Income Taxes
Chapter 2: Working with the Tax Law
End-of-Chapter Question, Exercise, and Problem Correlations

Individual Income Taxes 41e (2018)	Individual Income Taxes 42e (2019)	Individual Income Taxes 42e (2019) Learning Objectives	Exact Same	Revised	Brand New
Discussion Questions (DQ)					
DQ.02.01	DQ.02.01	LO1	x		
DQ.02.02	DQ.02.02	LO1	x		
DQ.02.03	DQ.02.03	LO1	x		
DQ.02.04	DQ.02.04	LO2, 5		x	
DQ.02.05	DQ.02.05	LO1, 2	x		
DQ.02.06	DQ.02.06	LO1	x		
DQ.02.07	DQ.02.07	LO1, 4	x		
DQ.02.08	DQ.02.08	LO1		x	
DQ.02.09	DQ.02.09	LO1, 5		x	
DQ.02.10	DQ.02.10	LO1		x	
DQ.02.11	DQ.02.11	LO1	x		
DQ.02.12	DQ.02.12	LO1	x		
DQ.02.13	DQ.02.13	LO1	x		
DQ.02.14	DQ.02.14	LO1	x		
DQ.02.15	DQ.02.15	LO1, 5		x	
DQ.02.16	DQ.02.16	LO1	x		
DQ.02.17	DQ.02.17	LO1	x		
DQ.02.18	DQ.02.18	LO1	x		
DQ.02.19	DQ.02.19	LO1	x		
DQ.02.20	DQ.02.20	LO1	x		
DQ.02.21	DQ.02.21	LO1	x		
DQ.02.22	DQ.02.22	LO1	x		
DQ.02.23	DQ.02.23	LO1	x		
DQ.02.24	DQ.02.24	LO1, 4	x		
DQ.02.25	DQ.02.25	LO2		x	
DQ.02.26	DQ.02.26	LO2		x	
DQ.02.27	DQ.02.27	LO2	x		
DQ.02.28	DQ.02.28	LO2	x		
DQ.02.29	DQ.02.29	LO2		x	
DQ.02.30	DQ.02.30	LO2	x		

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Individual Income Taxes 41e (2018)	Individual Income Taxes 42e (2019)	Individual Income Taxes 42e (2019) Learning Objectives	Exact Same	Revised	Brand New
DQ.02.31	DQ.02.31	LO1, 2	x		
DQ.02.32	DQ.02.32	LO3		x	
DQ.02.33	DQ.02.33	LO4	x		
DQ.02.34	DQ.02.34	LO2, 4	x		
DQ.02.35	DQ.02.35	LO6		x	
DQ.02.36	DQ.02.36	LO7		x	
Computational Exercises (EX)					
N/A					
Problems (PR)					
PR.02.37	PR.02.37	LO1	x		
PR.02.38	PR.02.38	LO1	x		
PR.02.39	PR.02.39	LO1	x		
PR.02.40	PR.02.40	LO1, 4	x		
PR.02.41	PR.02.41	LO4		x	
PR.02.42	PR.02.42	LO1, 2		x	
PR.02.43	PR.02.43	LO6		x	
Cumulative (Tax Return) Problems (CP)					
N/A					
Research Problems (RP)					
RP.02.01	RP.02.01		x		
RP.02.02	RP.02.02		x		
RP.02.03	RP.02.03		x		
RP.02.04	RP.02.04		x		
RP.02.05	RP.02.05		x		
RP.02.06	RP.02.06			x	
Becker CPA Review Questions (BCPA)					
N/A					

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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 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)

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

October 26, 2018

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. 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.

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.

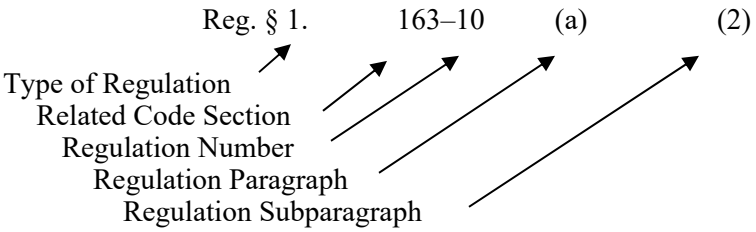
Sincerely,

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 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 24, 2018

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) 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. Here, the tax issue is probably important enough to do so.
- If Sri is likely to obtain an adverse letter ruling from the 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. 2018–3 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 (like 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) 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.

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- 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. 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, 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.

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)

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

July 9, 2018

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.

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

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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

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. Thus, 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, 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 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*).

27. (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.

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.

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.

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29. (LO 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; the AFTRs; and the West Publishing Co. reporter called the *Federal 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. 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:

- 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. The directory at **taxsites.com** may be useful.

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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. 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.

34. (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 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 by 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. Thus, 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. 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.

36. (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). The AICPA made a number of changes to the CPA exam, including increasing the number of simulations, in 2017.

PROBLEMS

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

38. (LO 1)
b. Exhibit 2.3.

39. (LO 1)
d. Exhibit 2.3.

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40. (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.

41. (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.

42. (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.

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43. (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.

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-wife'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, 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.

4. 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).

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

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SOLUTION TO ETHICS & EQUITY FEATURE

Reporting Tax Fraud (p. 2-7). Most individuals probably believe that it is ethical to report tax fraud. A 2014 IRS Oversight Board survey indicated that 86 percent of Americans believed that it was "not acceptable at all to cheat on taxes." On the other hand, that same survey indicated that 11 percent of taxpayers said that some cheating on their taxes was acceptable.

A number of organizations (including the IRS) provide estimates of the "tax gap," with the most recent IRS estimates indicating that the gross tax gap is around $458 billion, with $58 billion being collected eventually. The IRS divides the net gap into $291 billion by individuals, $35 billion by corporations, $79 billion by employment taxes, and $1 billion by estate and excise taxes.

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NOTES

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CHAPTER 2

WORKING WITH THE TAX LAW

LECTURE NOTES

OVERVIEW

Federal tax law is a mixture of statutory provisions, administrative pronouncements, and court decisions. Anyone who has attempted to work with this body of knowledge is familiar with its complexity. Tax research provides the vehicle by which one makes sense out of this complexity.

SUMMARY OF CHANGES IN THE CHAPTER

The following are notable changes in the chapter from the 2018 Edition. For major changes, see the Preface of the text.

- Created new Big Picture example and updated related examples throughout the chapter.
- Revised text to reflect Tax Cuts and Jobs Act (TCJA) of 2017 changes as needed.
- Updated references and citations throughout the chapter.
- Updated discussion of taxation on the CPA exam.

THE BIG PICTURE

The Big Picture discussion in Chapter 2 introduces the introductory tax student to the idea that answers to tax questions will not always be found in the tax textbook and that research often needs to be undertaken to answer the question.

The discussion in Section 2-3 of the chapter takes the student through the answer to the research questions posed. Depending on the research services available, the instructor might ask the students to formulate keyword searches and then demonstrate what happens when those searches are undertaken in the research service. The instructor could ask the students to see if they could verify the correctness of the textbook conclusion or change one of the key facts and determine how the conclusion would change, if at all.

TAX SOURCES

Statutory Sources of the Tax Law

1. Statutory sources of law include the Constitution (Article I, Sections 7, 8, and 10), tax treaties, and the Internal Revenue Code.

2. Origin of the Internal Revenue Code.

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a. 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.

b. 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.

c. 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.

3. The Legislative Process.

a. Exhibit 2.1 in the text illustrates the legislative process for enacting changes to the Internal Revenue Code of 1986.

b. 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.

c. 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.)

d. 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.

4. 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.

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

Administrative Sources of the Tax Law (See Exhibit 2.3 in the text.)

6. Treasury Department Regulations. The Treasury Department under § 7805(a) has a duty to issue rules and regulations to explain and interpret the Code.

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

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(1) 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.

(2) Final Regulations have the force and effect of law. Final Regulations are issued as Treasury Decisions (TDs) in the *Federal Register*. Regulations carry considerable authority as the official interpretation of tax statutes.

(3) Temporary Regulations are issues where immediate guidance is important.

b. Proposed, Temporary, and final Regulations are published in the *Federal Register*, in the *Internal Revenue Bulletin*, and by major tax services.

c. Regulations may also be classified as legislative, interpretive, or procedural.

7. Revenue Rulings and Revenue Procedures.

a. 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.

b. Revenue Procedures are issued in the same manner as Revenue Rulings, but they deal with the internal management practices and procedures of the IRS. Revenue Procedures do not carry the same legal force and effect as Regulations.

c. Both Revenue Rulings and Revenue Procedures serve an important function by providing guidance to IRS personnel and taxpayers in handling routine tax matters.

(1) They generally apply retroactively and are binding on the IRS until revoked or modified by subsequent rulings or procedures, Regulations, legislation, or court decisions.

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

(3) Revenue Rulings and other tax resources may be found at the IRS website: www.irs.gov.

8. 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.

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9. Other Administrative Pronouncements.

   a. 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*.

   b. The IRS also publishes other administrative communications in the *Internal Revenue Bulletin*, such as Announcements, Notices, IRs (News Releases), Internal Legal Memoranda (ILMs), Chief Counsel Notices (CC), and Prohibited Transaction Exemptions

   c. 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.

   d. A variety of internal memoranda that constitute the working law of the IRS also are released. These General Counsel Memoranda (GCMs), Technical Advice Memoranda (TAMs), Internal Legal Memoranda (ILMs), and Field Service Advice Memoranda (FSAs) are not officially published, and the IRS indicates that they may not be cited as precedents by taxpayers.

      (1) 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.

      (2) The Office of Chief Counsel prepares Field Service Advice Memoranda (FSAs) 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.

      (3) Some FSAs are being replaced by another form of field guidance called Technical Expedited Advice Memoranda (TEAMs). The purpose of TEAMs is to expedite legal guidance to field agents as disputes are developing. FSAs are reverting to their original purpose of case-specific development of facts.

Judicial Sources of the Tax Law

10. 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. (See Figure 2-1 at the end of the Lecture Notes for this chapter for the location of Judicial Sources.)

11. The Judicial Process in General. After a taxpayer has exhausted some or all of the remedies available within the IRS, the dispute can be taken to the Federal courts. The

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trial and appellate court system for Federal tax litigation is illustrated in Exhibit 2.4 in the text.

a. 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 these four trial courts: a Federal District Court, the U.S. Court of Federal Claims, the U.S. Tax Court, or the Small Cases Division of the U.S. Tax Court.

b. The Small Cases Division of the U.S. Tax Court hears only cases involving amounts of $50,000 or less. No appeal 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.

(1) This court hears cases involving disputed amounts of $50,000 or less.

(2) Informal proceedings.

(a) No necessity for the taxpayer to be represented by a lawyer or other tax adviser.

(b) Special trial judges, rather than Tax Court judges, preside over the proceedings.

(c) Decisions are not precedent for any other court and are not reviewable by any higher court.

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

d. 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, it becomes the petitioner (or appellant), and the taxpayer becomes the respondent.

12. 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.

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- Appeals.
- Bankruptcy.
- Gray areas.

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

    a. Generally, a three-judge panel hears a Court of Appeals case, but occasionally the full court decides more controversial cases.

    b. 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.

    c. The Federal Circuit provides the taxpayer with an alternative forum. When a particular Circuit Court of Appeals has issued an adverse decision in a similar case, the taxpayer may prefer the Court of Federal Claims route, because any appeal is to the Federal Circuit.

14. The Appellate Process. The role of the appellate court is limited to a review of the trial record compiled by the trial court. The appellate process usually involves a determination of whether the trial court applied the proper law in arriving at its decision.

    a. Bound by findings of facts unless they are clearly erroneous.

    b. The appellate court may approve (affirm) or disapprove (reverse) the lower court's findings, or it may send the case back for further consideration (remand).

    c. Appellate Precedents and the Tax Court. District Courts, the Tax Court, and the Court of Federal Claims must abide by the precedents set by the Court of Appeals of jurisdiction.

    d. All courts must follow the decision of the U.S. Supreme Court.

    e. 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 passed on the issue.

    f. 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.

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15. Judicial Citations. 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).

    a. 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.

        (1) Memorandum decisions deal with cases that involve only the application of established principles of law.

        (2) Regular decisions involve novel issues not previously resolved by the Tax Court.

        (3) In actual practice, both Regular and Memorandum represent the position of the Tax Court and, as such, can be relied on.

        (4) Regular Tax Court decisions are published by the U.S. Government Printing Office as the *Tax Court of the United States Reports*. Memorandum decisions are published by both CCH and RIA.

        (5) 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* as an *Action on Decision*.

    b. 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. Federal District Court decisions, dealing with both tax and nontax issues, also are published by West in its *Federal Supplement Second Series*.

    c. 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.).

Other Sources of the Tax Law

16. Tax Treaties. Tax legislation enacted in 1988 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.

17. Tax Periodicals. Can shorten the research time needed to resolve a tax issue.

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WORKING WITH THE TAX LAW—TAX RESEARCH TOOLS

Commercial Tax Services

18. 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:

    a. *Standard Federal Tax Reporter*, Commerce Clearing House.

    b. *CCH IntelliConnect*, Commerce Clearing House. The online version of the *Standard Federal Tax Reporter* (along with other CCH materials).

    c. *United States Tax Reporter*, Research Institute of America's (RIA), Thomson Reuters.

    d. Thomson Reuters *Checkpoint*, Research Institute of America. The online versions of RIA's *Federal Tax Coordinator 2d* and *United States Tax Reporter.*

    e. *Practical Tax Expert*, CCH/Wolters Kluwer.

    f. *Tax Management Portfolios*, Bloomberg BNA.

    g. *Mertens Law of Federal Income Taxation*, Thomson Reuters.

    h. Thomson Reuters *Westlaw* and *WestlawNext*—compilations include access to *Tax Management Portfolios*, *Federal Tax Coordinator 2d*, and *Mertens*.

    i. LexisNexis *TaxCenter*. A compilation of primary sources and various materials taken from CCH, Matthew Bender, Kleinrock, and Bloomberg BNA.

19. Assessing tax services. In terms of assessing the major tax services, the following points are relevant:

    a. Except for arrangement of the subject matter, there is not much difference between CCH's *Standard Federal Tax Reporter* and RIA's *United States Tax Reporter*.

    b. RIA's editorial content is generally more detailed than CCH's editorial content. The RIA editorial materials also contain more detailed tax-planning discussions. However, many practitioners feel that rule coverage and case law background are more extensive in CCH.

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c. Mertens is an excellent source if the emphasis is on background material for in-depth research. Mertens is, however, difficult reading due to its legalistic style. Also, updating is less frequent than most other services and not as accessible.

d. BNA's *Tax Management Portfolios* (TMPs) comprise a series of monographs on various subjects. As the treatment of a subject usually is exhaustive, a portfolio can serve as a convenient means of familiarizing the reader with the material. Note that portfolios are generally updated on a three-year cycle.

e. In summary, the day-to-day, all-purpose services are CCH and RIA. Mertens and the TMPs are useful for more extensive research and background.

Using Electronic (Online) Tax Services

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

21. Following certain general procedures can simplify the research process. The following suggestions may be helpful:

a. Choose keywords for the search carefully.

b. Take advantage of connectors.

c. Be selective in choosing a database.

d. Use a table of contents, index, or citation approach.

Noncommercial Electronic (Online) Tax Services

22. The internet provides a wealth of tax information in several popular forms, sometimes at no cost to the researcher.

23. A tax professional can access a significant amount of information that can assist in the research process.

a. Websites are provided by accounting and consulting firms, publishers, tax academics, libraries, and governmental bodies as a means of making information widely available. One of the best sites available to the tax professional is the Internal Revenue Service's home page, illustrated in Exhibit 2.6 of the text.

b. Exhibit 2.7 in the text lists some of the websites that may be most useful to tax researchers. The directory at taxsites.com provides links to accounting and tax sources (including international, state, and payroll tax sources).

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

WORKING WITH THE TAX LAW—TAX RESEARCH

24. Tax research is the process of finding a professional conclusion to a tax problem. The problem might originate either from completed or proposed transactions.

25. Tax research involves the following procedures (illustrated in Exhibit 2.8 in the text):

a. Identifying and refining the problem.

b. Locating the appropriate tax law sources.

c. Assessing the validity of the tax law sources.

d. Arriving at the solution or at alternative solutions with due consideration given to nontax factors.

e. Effectively communicating the solution to the taxpayer or the taxpayer's representative.

f. Updating the solution in light of new developments.

Identifying the Problem

26. 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.

Refining the Problem

27. Use new facts to refine the tax problem.

Locating the Appropriate Tax Law Sources

28. Once the problem is clearly defined, we index the volume of a hard copy tax service or a keyword search on an online tax service.

Assessing the Validity of the Tax Law Sources

29. 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.

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30. Interpreting the Internal Revenue Code. This is the greatest challenge for the IRS. The language of the Code is difficult to comprehend fully.

31. Assessing the Validity of a Treasury Regulation.

    a. Give the Code equal weight when dealing with taxpayers and their representatives.

    b. Proposed regulations are not binding.

    c. The burden of proof is on the taxpayer.

    d. If the taxpayer loses the challenge, then a 20% negligence penalty may be imposed.

    e. Final regulations can be classified as procedural, interpretive, or legislative. Procedural Regulations are housekeeping-type instructions indicating information that taxpayers should provide the IRS.

    f. Interpretive regulations are hard and solid and almost impossible to overturn.

    g. 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.

    h. Courts tend to apply the legislative reenactment doctrine.

32. Assessing the Validity of Other Administrative Sources of the Tax Law. In any dispute with the IRS on the interpretation of tax law.

33. 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:

    a. The level of court. The higher the level of the court that issued a decision, the greater the weight accorded to that decision.

    b. 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.

    c. Regular or Memorandum decision. A Tax Court Regulator decision carries more weight than a memorandum decision, because the Tax Court does not consider memorandum decisions to be binding.

    d. Supreme Court certiorari. A Circuit Court decision where certiorari has been requested and denied by the U.S. Supreme Court carries more weight than a Circuit Court decision that was not appealed.

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e. 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.

f. Status on appeal. The weight of a decision also can be affected by its status on appeal.

g. 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.

34. Assessing the Validity of Other Sources. (See Table 2-1 at the end of the Lecture Notes for this chapter for a list of primary and secondary sources.)

a. Primary sources of tax law include the Constitution, legislative history materials, statutes, treaties, Treasury Regulations, IRS pronouncements, and judicial decisions.

b. 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.

c. For purposes of the accuracy-related penalty, the IRS expanded the list of substantial authority *for purposes of* the accuracy-related penalty in § 6662 to include a number of secondary materials.

d. A letter ruling or determination letter is substantial authority only for the taxpayer to whom it is issued, except for the accuracy-related penalty.

e. 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.

FINANCIAL DISCLOSURE INSIGHTS

Where Does GAAP Come From? In reconciling the tax and financial accounting reporting of a transaction, the tax professional needs to know the hierarchy of authority of accounting principles—in particular, the level of importance to assign to a specific GAAP document. Discuss the diagram presented in the text which shows the sources of GAAP, arranged in a general order of authority from highest to lowest.

Arriving at the Solution or at Alternative Solutions

35. Discuss possible solutions to The Big Picture questions.

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Communicating Tax Research

36. 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:
    - A clear statement of the issue.
    - A short review of the facts that raise the issue.
    - A review of the pertinent tax law source.
    - 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.

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

WORKING WITH THE TAX LAW—TAX PLANNING

38. Tax research and tax planning are inseparable.

    a. The primary purpose of effective tax planning is to reduce the taxpayer's total tax bill.

    b. The secondary objective of effective tax planning is to reduce or defer the tax in the current tax year.

Nontax Considerations

39. 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.

Components of Tax Planning

40. 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.

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

    a. Avoid the recognition of income.

    b. Defer the recognition of income.

    c. Convert the classification of income.

    d. Choose the business entity with the desired tax attributes.

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e. Preserve formalities by generating and maintaining supporting documentation.

f. Act in a manner consistent with the intended objective.

Tax Avoidance and Tax Evasion

42. Avoidance versus evasion. 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.

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

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

Follow-Up Procedures

43. 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.)

Tax Planning

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

TAXATION ON THE CPA EXAMINATION

45. The CPA exam was revised in 2017. 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).

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

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

b. Total testing time is 16 hours.

c. Multiple-choice questions and task-based simulations each contribute about 50% toward the candidate's score in the AUD, FAR, and REG sections. In the BEC

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section, multiple-choice questions contribute about 50% of the scoring, with 35% coming from task-based simulations and 15% from written communication.

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

e. The revised CPA exam tests remembering and understanding, application, analysis, and evaluation. The previous CPA exam only tested for the first two of these items.

Preparation Blueprints

47. To prepare for the revised CPA exam, candidates are able to use new AICPA-developed blueprints that replaced the Content Specification Outline (CSO) and Skill Specification Outline (SSO).

48. The blueprints provide candidates with more detail about what to expect on the exam and contain about 600 representative tasks.

49. The blueprints provide candidates with sample tasks that align with both the content and skill level at which the content will be tested.

Regulation Section

50. 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).

51. 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%).

52. Candidates can learn more about the CPA examination at www.cpa-exam.org. This online tutorial site's topics include:
- Common tools.
- Navigation.
- Form completion.
- Numeric entry.
- Research questions.
- Authoritative literature search.
- Written communication.

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Table 2-1
Primary and Secondary Tax Law Sources

	Primary	Secondary
Sixteenth Amendment to Constitution	X	
Tax Treaty	X	
Internal Revenue Code Section	X	
U.S. Supreme Court Decision	X	
U.S. Circuit Court of Appeals Decision	X	
Tax Court Memorandum Decision	X	
Tax Court Regular Decision	X	
U.S. District Court Decision	X	
U.S. Court of Federal Claims Decision	X	
Small Cases Division of U.S. Tax Court	X**	
Final Regulation	X	
Temporary Regulation	X*	
Proposed Regulation	X***	
Revenue Ruling	X	
Revenue Procedure	X	
Senate Finance Committee Report	X	
Bluebook		X
Letter Ruling		X
Technical Advice Memorandum		X
Actions on Decisions		X
Determination Letter		X
Harvard Law Review article		X
Field Service Advice		X
General Counsel Memorandum		X

* Can be outstanding for three years at most.

The categorization of a tax law source as a primary or a secondary source is not black and white. All of the sources categorized as primary in the above table are so categorized because all can be relied on to defend against the application of penalties by the IRS. However, note the following:

** The Tax Court indicates that Small Cases Division opinions should not be used or cited as precedent. As such, these decisions could be categorized as secondary sources.

*** Proposed regulations are not binding. That is, a taxpayer is not required to follow the guidance in the proposed regulation unless (or until) the regulation becomes final. This could lead to the categorization of a proposed regulation as a secondary source.

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Figure 2-1
Location of Judicial Sources

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

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Notes for Figure 2-1:

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

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

c Both CCH and RIA have separate reporters for Regular, Memorandum, and Small Cases Division decisions of the U.S. Tax Court.

d All decisions (both tax and nontax) of the U.S. Court of Federal Claims are published by the U.S. GPO in the *Claims Court Reporter Series*. From 1960 to October 1, 1982, Court of Claims decisions were published in the *Court of Claims Reporter Series*.

e From 1932 to 1960, the Court of Claims decisions were published in the *F.Supp. Series*. Beginning October 1982, the Claims Court decisions are published in the *Claims Court Reporter*. Beginning on October 30, 1992, the Claims Court underwent a further name change. The new designation, U.S. Court of Federal Claims, begins with Volume 27 of the former *Cl.Ct.* (West citation) now abbreviated as *Fed.Cl.*

f "All cases" has reference to nontax as well as tax decisions. Thus, it would include such varied issues as interstate transportation of stolen goods, civil rights violations, and anti-trust suits.

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ETHICS AND EQUITY FEATURES

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

RESEARCH PROBLEMS

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

IN-CLASS EXERCISES

Q1. The shareholders of Red Corporation and Green Corporation want assurance that the consolidation of both into a single corporation, Blue Corporation, will be a nontaxable reorganization. Should a letter ruling or a determination letter be requested from the IRS? Explain when each is used.

Solution:
The proper approach is to request that the National Office of the IRS issue a letter ruling concerning the income tax effect of the proposed transaction. Letter rulings are issued for a fee upon a taxpayer's request and describe how the IRS will treat a proposed transaction for tax purposes. They apply only to the taxpayer who asks for and obtains the ruling. Letter rulings can be useful to taxpayers who want to be certain of how a transaction will be taxed before proceeding. Letter rulings also allow taxpayers to avoid unexpected tax costs and may be the most effective way to carry out tax planning. However, the IRS limits the issuance of individual rulings to restricted, preannounced areas of taxation.

Determination letters are issued at the request of taxpayers and provide guidance on the application of the tax law. They differ from letter rulings in that the issuing source is an IRS Area Director (rather than the National Office of the IRS). Also, determination letters usually involve completed (as opposed to proposed) transactions.

Q2. During the year, Amy earned $2,000 working as an independent consultant. She has decided not to declare the income on her return since no 1099s were issued to her. Is this considered tax avoidance or tax evasion?

Solution:
A fine line exists between legal tax planning and illegal tax planning—tax avoidance versus tax evasion. Tax avoidance is merely tax minimization through legal techniques, which is the proper objective of all tax planning. Tax evasion, while also aimed at the elimination or reduction of taxes, connotes the use of subterfuge and fraud as a means to an end. Since Sue has chosen not to report the income on her return, she has committed tax evasion.

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