South Western Federal Taxation 2019 Essentials of Taxation Individuals and Business Entities 22nd edition Raabe Solutions Manual

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SWFT 2019 Essentials of Taxation
Chapter 2: Working with the Tax Law
End-of-Chapter Question, Exercise, and Problem Correlations

Essentials of Taxation 41e (2018)	Essentials of Taxation 42e (2019)	Essentials of Taxation (2019) Learning Objectives	Exact Same	Revised	Brand New	Source Volume: Ind. Income Taxes 42e (2019) OR Corporations 42e (2019)	Source Volume Chapter	Source Volume Question, Problem, or Exercise #
Discussion Questions (DQ)								
N/A								
Computational Exercises (EX)								
N/A								
Problems (PR)								
PR.02.01	PR.02.01	LO1	x			V1	2	PR22
PR.02.02	PR.02.02	LO1, 3		x		V1	2	PR4
PR.02.03	PR.02.03	LO1	x					
PR.02.04	PR.02.04	LO1, 2	x			V1	2	PR7
PR.02.05	PR.02.05	LO1	x			V1	2	PR8
PR.02.06	PR.02.06	LO1	x			V1	2	PR14
PR.02.07	PR.02.07	LO1, 3	x			V1	2	PR15
PR.02.08	PR.02.08	LO1	x			V1	2	PR17
PR.02.09	PR.02.09	LO1	x			V1	2	PR20
PR.02.10	PR.02.10	LO1	x			V1	2	PR21
PR.02.11	PR.02.11	LO1	x			V1	2	PR18
PR.02.12	PR.02.12	LO1, 2	x			V1	2	PR24
PR.02.13	PR.02.13	LO1	x					
PR.02.14	PR.02.14	LO1	x					
PR.02.15	PR.02.15	LO2	x			V1	2	PR27
PR.02.16	PR.02.16	LO2	x			V1	2	PR28
PR.02.17	PR.02.17	LO2	x			V1	2	PR31
PR.02.18	PR.02.18	LO2	x					
PR.02.19	PR.02.19	LO2, 4		x		V1	2	PR32
PR.02.20	PR.02.20	LO1, 2	x					
PR.02.21	PR.02.21	LO1	x					
PR.02.22	PR.02.22	LO1, 2	x					
PR.02.23	PR.02.23	LO1, 2	x			V1	2	PR41
PR.02.24	PR.02.24	LO1	x			V1	2	PR37
PR.02.25	PR.02.25	LO1, 2	x			V1	2	PR38
PR.02.26	PR.02.26	LO1, 2	x			V1	2	PR25

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PR.02.27	PR.02.27	LO1	x			V1	2	PR26
PR.02.28	PR.02.28	LO2	x					
PR.02.29	PR.02.29	LO1, 4	x					
PR.02.30	PR.02.30	LO2, 3	x					
Cumulative (Tax Return) Problems (CP)								
N/A								
Bridge Discipline (BD)								
BD.02.01	BD.02.01		x					
BD.02.02	BD.02.02		x					
BD.02.03	BD.02.03		x					
BD.02.04	BD.02.04		x					
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			V1	2	RP1
RP.02.05	RP.02.05		x					
RP.02.06	RP.02.06		x			V1	2	RP2
RP.02.07	RP.02.07		x					
RP.02.08	delete							
RP.02.09	RP.02.08		x					
RP.02.10	RP.02.09		x					
Becker CPA Review Questions (BCPA)								
N/A								

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CHAPTER 2

WORKING WITH THE TAX LAW

SOLUTIONS TO PROBLEM MATERIALS

PROBLEMS

1. (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.

2. (LO 1, 3)

Raabe, Young, Nellen, & Maloney, 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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3. (LO 1)

a. Treasury Regulations are issued by the U.S. Treasury Department, while Revenue Rulings are issued by the National Office of the IRS. Both Regulations and Revenue Rulings are designed to provide an interpretation of the tax law. However, Rulings do not have the same legal force and effect as do Regulations. Usually, Rulings deal with more restricted problems. Rulings "are published to provide precedents to be used in the disposition of other cases and may be cited and relied upon for that purpose." See Rev.Proc. 86–15, 1986–1 C.B. 544.

b. Revenue Procedures are issued in the same manner as are Revenue Rulings, but Procedures deal with the internal management practices and requirements of the IRS. Familiarity with these Procedures can increase taxpayer compliance and assist the efficient administration of the tax law by the IRS.

c. Letter rulings are issued upon a request. They describe how the IRS will treat a proposed transaction. Unlike Revenue Rulings, letter rulings apply only to the taxpayer who applies for and obtains the ruling, and generally, "may not be used or cited as precedent" [§ 6110(k)(3)]. Letter rulings, used to be "private" (i.e., the content of the ruling was made available only to the taxpayer that requested the ruling). However, Federal legislation and the courts have forced the IRS to modify its position on the confidentiality of letter rulings. Such rulings now are published by a number of commercial tax services.

d. Like letter rulings, determination letters are issued at the request of taxpayers. They provide guidance concerning the application of the tax law. They differ from letter rulings in that the issuing source is the taxpayer's own District Director rather than the National Office of the IRS. In addition, determination letters usually involve completed (as opposed to proposed) transactions. Determination letters are not published, but are made known only to the party making the request.

4. (LO 1, 2) 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.

5. (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.

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6. (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.

7. (LO 1, 3)

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

July 9, 2019

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 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

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8. (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.

9. (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

10. (LO 1) See Exhibit 2.5.

   a. Tenth.

   b. Eighth.

   c. Ninth.

   d. Fifth.

   e. Seventh.

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

12. (LO 1, 2)

   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.

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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.

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.

13. (LO 1) The differences between a Regular decision, a Memorandum decision, and a Summary Opinion of the U.S. Tax Court are summarized as follows:

- In terms of substance, Memorandum decisions deal with situations that require only the application of previously established principles of law. Regular decisions involve novel issues that have not been resolved by the Court. In actual practice, however, this distinction is not always observed.
- Memorandum decisions officially were published until 1999 in mimeograph form only, but Regular decisions are published by the U.S. Government in a series that is designated as the *Tax Court of the United States Reports*. Memorandum decisions are now published on the Tax Court website. Both Regular and Memorandum decisions are published by various commercial tax services (e.g., CCH and RIA).
- A Summary Opinion is a Small Cases Division case involving amounts of $50,000 or less. They are not precedents for any other court decisions and are not reviewable by any higher court. Proceedings are timelier and less expensive than a Memorandum or Regular decision. Small cases decisions are published as Summary Opinion, found commercially and on the U.S. Tax Court website.

14. (LO 1)

a. CA–2. An abbreviation that designates the U.S. Second Circuit Court of Appeals.

b. Fed.Cl. An abbreviation for the Federal Claims Reporter published by West Publishing Company. It includes the decisions of the U.S. Court of Federal Claims and begins with Volume 27.

c. *aff'd*. An abbreviation for "affirmed," which indicates that a lower court decision was affirmed (approved of) on appeal.

d. *rev'd*. An abbreviation for "reversed," which indicates that a lower court decision was reversed (disapproved of) on appeal.

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e. *rem'd*. An abbreviation for "remanded," which indicates that a lower court decision is being sent back by a higher court for further consideration.

f. *Cert. denied*. The Writ of Certiorari has been denied by the U.S. Supreme Court. This Writ means that the Court will not accept an appeal from a lower court and, therefore, will not consider the case further.

g. *acq*. An abbreviation for "acquiescence" (agreement). The IRS follows a policy of either acquiescing or nonacquiescing to certain decisions.

h. B.T.A. An abbreviation for the Board of Tax Appeals. From 1924 to 1942, the U.S. Tax Court was designated as the Board of Tax Appeals.

i. USTC. U.S. District Court, U.S. Circuit Court of Appeals, U.S. Court of Federal Claims, and U.S. Supreme Court decisions that address Federal tax matters are reported in the Commerce Clearing House U.S. Tax Cases (USTC) and the RIA (formerly P-H) American Federal Tax Reports (AFTR) series.

j. AFTR. See the solution to part i. above.

k. F.3d. All of the decisions (both tax and nontax) of the U.S. Claims Court (before October 1982) and the U.S. Circuit Court of Appeals are published by West Publishing Company in a reporter that is designated as the Federal Reporter, Second Series (F.2d). Volume 999, published in 1993, is the last volume of the Federal Second Series. It is followed by the Federal Third Series (F.3d).

l. F.Supp. Most Federal District Court decisions, dealing with both tax and nontax issues, are published by West Publishing Company in its Federal Supplement Series (F.Supp.).

m. USSC. An abbreviation for the U.S. Supreme Court.

n. S.Ct. West Publishing Company publishes all of the U.S. Supreme Court decisions in its Supreme Court Reporter (S.Ct.).

o. D.Ct. An abbreviation for a U.S. District Court decision.

15. (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.

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16. (LO 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.

17. (LO 2)

a. Yes. Exhibit 2.3.

b. No. Not published there.

c. No. Published by private publishers. Exhibit 2.3.

d. Yes. Exhibit 2.3.

e. Yes. Exhibit 2.3.

f. No.

g. Yes. Exhibit 2.3.

h. No.

18. (LO 2)

a. The U.S. Tax Court.

b. Yes, the appellate court affirmed, or agreed with, the trial court.

c. United Draperies, Inc., the taxpayer.

d. Yes, in effect, by issuing cert. denied to the appellate court decision (refusing to hear the decision).

19. (LO 2, 4) 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).

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- 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.

20. (LO 1, 2)

a. Tom has some false notions. He must sue in the U.S. District Court of his locality and not in any other U.S. District Court.

b. Tom has four choices of courts with respect to his Federal tax question, and a state court is not one of the choices. He may go to the U.S. Tax Court, Small Cases Division of the U.S. Tax Court, U.S. District Court, or U.S. Court of Federal Claims.

c. The B.T.A. decision is an old U.S. Tax Court decision that may have little validity today. Even if the decision still is good law, it probably will have little impact upon a U.S. District Court and certainly no impact upon a state court.

d. The U.S. Court of Federal Claims is a trial court that usually meets in Washington, D.C., and Tom cannot appeal from a U.S. District Court to the U.S. Court of Federal Claims. Any appeal from his U.S. District Court would be to the Sixth Circuit Court of Appeals (and not to the Second).

e. Few tax decisions reach the U.S. Supreme Court. The U.S. Supreme Court must agree to hear a court case.

21. (LO 1)

a. T.

b. C (before October 1982) and A.

c. D, C, A, and U.

d. D, C, A, and U.

e. U.

f. C and U.

g. D.

h. D, T, and C.

i. A and U.

j. C.

k. T.

l. T.

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South Western Federal Taxation 2019 Essentials of Taxation Individuals and Business Entities 22nd edition Raabe Solutions M

22. (LO 1, 2)
a. N, a cite for an IRS Revenue Ruling.
b. T, U.S. Tax Court.
c. A, U.S. Circuit Court of Appeals.
d. U, U.S. Supreme Court.
e. T, U.S. Tax Court (previous name of the Tax Court).
f. D, U.S. District Court.
g. T, U.S. Tax Court.
h. N, a cite for a Letter Ruling.
i. T, U.S. Tax Court's Small Cases Division decision.

23. (LO 1, 2)
a. P.
b. P.
c. P.
d. S.
e. P.
f. S.
g. P. Valid for three years.
h. P.
i. N.
j. P.

24. (LO 1)
b. Subchapter C.

25. (LO 1, 2)
b. Exhibit 2.3.

26. (LO 1, 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.

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

28. (LO 2) Tax research serves two major functions: (a) alerting the tax advisor to planning opportunities and documentation requirements that can reduce a taxpayer's liability through alternative means of structuring a transaction and (b) determining the correct treatment of completed transactions to ensure accurate compliance with U.S. tax laws. A professional approach to client service, therefore, demands thorough tax research as part of the job. Attention to the requirements of our country's tax laws is also

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mandated by the canons of professional ethics and the regulations applicable to professional tax preparers. Although some clients might prefer a head-in-the-sand approach to tax compliance, the range of potential penalties and interest charges make knowledge of the likely tax treatment of a particular transaction imperative.

The low IRS audit rate, moreover, does not justify playing the "audit lottery." Besides, this low rate masks much higher audit rates for certain categories of taxpayers and certain types of income—including returns prepared by persons known by the IRS to be negligent or unduly aggressive.

29. (LO 1, 4) This problem requires that students access various sites on the internet. Thus, each student's solution likely will vary from that of the others.

You should determine the skill and experience levels of the students before making the assignment, coaching them where necessary so as to broaden the scope of the exercise to the entire available electronic world.

Make certain that you encourage students to explore all parts of the World Wide Web in this process, including the key tax sites, but also information found through the websites of newspapers, magazines, businesses, tax professionals, government agencies, political outlets, and so on. They should work with internet resources other than the Web as well, including newsgroups and other interest-oriented lists.

30. (LO 2, 3) Build interaction into the exercise wherever possible, asking the student to send and receive e-mail in a professional and responsible manner.

a. Section 61(a)(13): Gross income of a taxpayer includes distributive share of partnership gross income.

b. Section 643(a)(2): Distributable net income of a trust or estate is computed without allowing a deduction for a personal exemption.

c. Section 2503(g)(2)(A): The term "qualified work of art" means any archaeological, historic, or creative tangible personal property.

BRIDGE DISCIPLINE PROBLEMS

1. a. There is a correspondence between the sources of the Federal tax law and the three branches of the law as described in the U.S. Constitution. Congress is the legislative branch, Treasury and the IRS are the executive branch, and the courts are the judicial branch.

But the IRS likely is more aggressive than most other federal agencies, despite its current "customer service" orientation. And there are few federal courts in which the taxpayer's chances of prevailing are so low as they are in tax litigation.

And one seldom sees elsewhere the power of the congressional committees assigned to shepherd tax proposals to a vote.

Remembering the quote of von Bismarck, the making of tax law is a creature unto itself, unparalleled elsewhere in the federal system today.

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b. The high costs of tax litigation, and the low probabilities of success once a taxpayer reaches the court, diminish the checks-and-balances feature of the federal tax system. Very few taxpayer pockets are "deep enough" to pursue a regular strategy of litigation to find the correct computation of one's tax liability. Thus, the government holds an important advantage over the taxpayer in working through the adversarial system that comprises today's federal tax structure.

At least there are plenty of opportunities for the taxpayer to reach an agreeable settlement with the government. The path through IRS appeals has a number of intermediate stops at which the parties can measure the strength of each other's position and negotiate a settlement in computing the tax due. Perhaps this is the trade-off at hand: Negotiated settlements save all parties time and money, even though they are not mentioned in the Constitution or the Revenue Code.

2. Solution will vary by student.

3. Solution will vary by student.

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

RESEARCH PROBLEMS

1. a. In this Tax Court Memorandum decision, the court upheld the taxpayer's claim for the American Opportunity tax credit finding that the Form 1098-T she received was incorrect.

b. In this letter ruling, a proposed merger between members of an affiliated group qualified for tax-free reorganization treatment under § 355.

c. The IRS issued a nonaquiescence to *Estate of Smith,* 198 F.2d 515 (CA–5, 1999).

2. a. Code § 708(a) provides that an existing partnership shall be considered as continuing if it is not terminated.

b. Code § 1371(a) provides that, with exceptions, Subchapter C shall apply to S corporations and its shareholders.

c. Code § 2503(a) provides that the term "taxable gifts" means the total amount of gifts made during the calendar year, less the deductions provided in Subchapter C.

3. a. Regulation § 1.170A–4(A)(b)(2)(ii)(C) provides that the care of the ill means alleviation or cure of an existing illness and includes care of the physical, mental, or emotional needs of the ill.

b. Regulation § 1.672(b)–1 defines a nonadverse party as any person who is not an adverse party.

c. Regulation § 20.2031–7(f) provides several tables for valuation of annuities, life estates, terms for years, and remainders.

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4. 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.

5. Using the citation, find the case in RIA *Checkpoint* or find the case on the U.S. Tax Court website (www.ustaxcourt.gov), under "Opinions Search" tab.

   The issue in *Green* concerns the deductibility of commuting expenses. The taxpayer, Thomas Green, was a television executive whose office, his primary place of work, was in Manhattan. However, Mr. Green claimed that the den in his Long Island home was also a place of business because he worked there in the evenings. As a result, Mr. Green deducted the commuting costs he incurred driving between his home and his clients' offices, on the way to his Manhattan office. The Tax Court concluded that these costs were nondeductible commuting expenses.

   Mr. Green used an IRS publication (Publication 17, *Your Federal Income Tax*) to support the conclusion that his expenses were deductible commuting expenses. However, IRS publications are not primary sources of tax law on which research conclusions should be based. This was confirmed by the Tax Court. In the opinion, the judge said that even if the sentence taken out of context from the publication could support Mr. Green's conclusion, "…the sources of authoritative law in the tax field are the statute and regulations, and not informal publications such as Your Federal Income Tax."

6. 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."

7. In the Tax Court case *Kathryn Bernal*:

   a. Docket number 930-02.

   b. Filed on February 20, 2003.

   c. Respondent is David Jojola for the IRS.

   d. Kathryn Bernal, the taxpayer, acted as her own attorney (e.g., pro se).

   e. This case was assigned to and written by the Chief Trial Judge Peter J. Panuthos.

   f. The court granted respondent's (IRS) motion to dismiss for lack of jurisdiction. Taxpayer mailed her petition beyond the 3-year available time period.

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Research Problems 8 and 9

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

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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 a new fact pattern for the Big Picture.
- Updated the Conference Committee Exhibit 2.2 for the TCJA of 2017

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 2-2 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 also ask the students to see if they could verify the correctness of the textbook conclusion or change one of the key facts and to determine how the conclusion would change, if at all.

TAX LAW 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.

    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.

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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 for an illustration of what happened with amendments to the child tax credit in the drafting of the Tax Cuts and Jobs Act of 2017.)

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.

6. Effect of Treaties. The United States signs certain tax treaties (sometimes called tax conventions) with foreign countries to render mutual assistance in tax enforcement and to avoid double taxation.

a. These treaties affect transactions involving U.S. persons and entities operating or investing in a foreign country, as well as persons and entities of a foreign country operating or investing in the United States.

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b. Neither a tax law nor a tax treaty automatically takes precedence. When there is a direct conflict, the most recent item prevails.

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

7. Treasury Department Regulations. The Treasury Department has a duty to issue rules and Regulations to explain and interpret the Code.

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

      (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.

8. 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.

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(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.

9. 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.

10. 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.

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Judicial Sources of the Tax Law

11. 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 these Lecture Notes for the location of judicial sources.)

12. After a taxpayer has exhausted some or all the remedies available within the IRS, the dispute can be taken to the Federal courts. The trial and appellate court system for Federal tax litigation is illustrated in Exhibit 2.4 in the text.

    a. A court of original jurisdiction initially hears the case.

    b. Appeals (either by the taxpayer or the IRS) are heard by the appropriate appellate court.

    c. 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.

    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.

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

14. 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. *Process and Outcomes.* If the government loses at the trial court level (District Court, Tax Court, or Court of Federal Claims), it may decide not to appeal.

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(1) The fact that the IRS does not appeal does not mean that the IRS agrees with the result.

(2) 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.

(3) 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).

b. *Other Rules and Strategies.* The Federal Circuit at the appellate level provides a taxpayer with an alternative forum to the Court of Appeals of his or her home circuit.

(1) District Courts, the Tax Court, and the Court of Federal Claims must abide by the precedents set by the Court of Appeals of jurisdiction.

(2) All courts must follow the decision of the U.S. Supreme Court.

(3) 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.

(4) 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.

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.

a. Judicial Citations—The Tax Court. The 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.

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(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 District Courts, 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—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.).

WORKING WITH THE TAX LAW—TAX RESEARCH

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

17. Tax research involves the following procedures (illustrated in Exhibit 2.6 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. (See Table 2-1 at the end of the Lecture Notes for a list of primary and secondary 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.

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Identifying the Problem

18. Problem identification must start with a compilation of the relevant facts involved. In other words, all the facts that may have a bearing on the problem must be gathered.

Refining the Problem

19. Use new facts to refine the tax problem.

Locating the Appropriate Tax Law Sources

20. 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.

21. Tax Services. Several important observations about the use of tax services should be emphasized.

    a. Always check for current developments. Tax services are updated several times a day, and tax newsletters often feature highlights of recent tax law developments.

    b. There is no substitute for the original source. Do not base a conclusion solely on a tax service's commentary. If a Code Section, Regulation, or case is vital to the research, read it.

22. Tax Commentary. Various tax publications are another source of relevant information. If an article or a posting is relevant to the issue at hand, it may provide the references needed to locate the primary sources of the tax law that apply

Assessing Tax Law Sources

23. 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.

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

25. Assessing the Significance 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.

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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.

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

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

b. The legal 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. The type of decision. A Tax Court Regular decision carries more weight than a Memorandum decision; the Tax Court does not consider Memorandum decisions to have precedential value.

d. The weight of the decision. A decision that is supported by cases from other courts carries more weight than a decision that is not supported by other cases.

e. Subsequent events. Was the decision affirmed or overruled on appeal?

f. In connection with the last two factors, 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.

28. Understanding Judicial Opinions. Reading judicial opinions can be more productive if certain conventions of usage are understood.

a. Some courts, including the Tax Court, apply the terms *petitioner* and *respondent* to the plaintiff and defendant, respectively, particularly when the case does not involve an appellate proceeding.

b. Appellate courts often use the terms *appellant* and *appellee* instead.

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c. It also is important to distinguish between a court's final determination, or holding, and passing comments made in the course of its opinion. These latter remarks, examples, and analogies, often collectively termed dicta, are not part of the court's conclusion and do not have precedential value.

29. Assessing the Significance of Other Sources. (See Table 2-1 at the end of these Lecture Notes for a list of primary and secondary tax law 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.

Arriving at the Solution or at Alternative Solutions

30. Discuss possible solutions to Example 4 in the text.

Communicating Tax Research

31. A good tax research communication 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.

32. Exhibits 2.7 and 2.8 in the text present the tax file memorandum (internal to the firm) and the client letter associated with the facts of Example 4 in the text.

Updates

33. Because tax research may involve a proposed (as opposed to a completed) transaction, a change in the tax law (legislative, administrative, or judicial) could alter the original conclusion.

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Tax Research Best Practices

34. The researcher must use the document list that results from a search procedure in a professional manner. Most electronic tax services allow a user to retrieve documents in order of relevance, or in the order listed by database sources.

35. Finding Relevant Materials Effectively. Usually, tax professionals use one of the following strategies when performing computer-based tax research.

    a. Search various databases using keywords that are likely to be found in the underlying documents, as written by Congress, the judiciary, or administrative sources.

    b. Link to tax documents for which all or part of the proper citation is known.

    c. Browse the tax databases, examining various tables of contents and indexes in a traditional manner or using cross-references in the documents to jump from one tax law source to another.

    d. Sometimes a researcher can begin a search process using materials that are available at no direct cost. Such sources include the following.
    - The Web. Exhibit 2.9 in the text lists some of the websites that may be most useful to tax researchers and their internet addresses as of press date.
    - Blogs and newsletters.

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.

TAX RESEARCH ON THE CPA EXAMINATION

36. The CPA examination includes tax-oriented questions in the following topical areas.
    - Federal tax procedures, ethics, and accounting issues.
    - Federal taxation of property transactions.
    - Federal taxation—individuals.
    - Federal taxation—entities.

37. Questions address issues involving tax compliance and tax planning matters.

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38. Each exam section includes multiple-choice questions and case studies called task-based simulations (TBSs).

    a. About 60 multiple-choice tax questions appear in the Regulation section of the exam.

    b. TBSs are small case studies designed to test a candidate's tax knowledge and skills using real-life work-related situations.

    c. The typical TBS requires 15–30 minutes to complete.

39. Candidates can learn more about the CPA examination at www.nasba.org/exams/cpa-exam. This online tutorial site reviews the exam's format, navigation functions, and tools. A 30- to 60-minute sample exam will familiarize a candidate with the types of questions on the examination.

RESEARCH PROBLEMS

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

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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. Chris operates a barbershop in which he employs eight barbers. To comply with the rules governing income tax and payroll tax withholding, Chris wants to know whether the barbers working for him are employees or independent contractors.

Solution:
The proper procedure is to request a determination letter on their status from the appropriate Area Director.

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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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CHAPTER

2

Working With the Tax Law

Essentials of Taxation

SOUTH-WESTERN FEDERAL TAXATION

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The Big Picture (slide 1 of 2)

- Early in November 2018, Fred and Megan scheduled a meeting with you to discuss a potential tax problem.
  - Fred and Megan purchased a 40-acre parcel of property in 2013 for $195,000.
    - On it, they built their “dream home” in 2014.
  - In March 2018, while walking on a remote part of their property, they spotted something shiny on the ground.
    - They started digging and eventually unearthed eight metal cans containing more than 1,400 rare gold coins in $5, $10, and $20 denominations dated from 1846 to 1895.
    - The face value of the gold coins is about $28,000, and the coins are in mint condition

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The Big Picture (slide 2 of 2)

- Their delay in coming to you for tax advice was due to a state law that required their discovery to be turned over to the state for disposition.
  - The state, for a period of six months, was required to publicize the find and ask if anyone could prove ownership.
  - When no one came forward, the coins were returned to the Martels in October 2018.
- As they are now the rightful owners of the coins, they want to know the tax implications (if any) of their discovery.

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Statutory Sources of Tax Law
(slide 1 of 2)

- Internal Revenue Code
  - Codification of the Federal tax law provisions in a logical sequence
  - Have had three codes:
    - 1939, 1954, 1986

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Statutory Sources of Tax Law
(slide 2 of 2)

- Example of Code Citation: § 2(a)(1)(A)
  - § = Abbreviation for "Section"
  - 2 = section number
  - (a) = subsection number
  - (1) = paragraph designation
  - (A) = subparagraph designation

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Legislative Process for Tax Bills

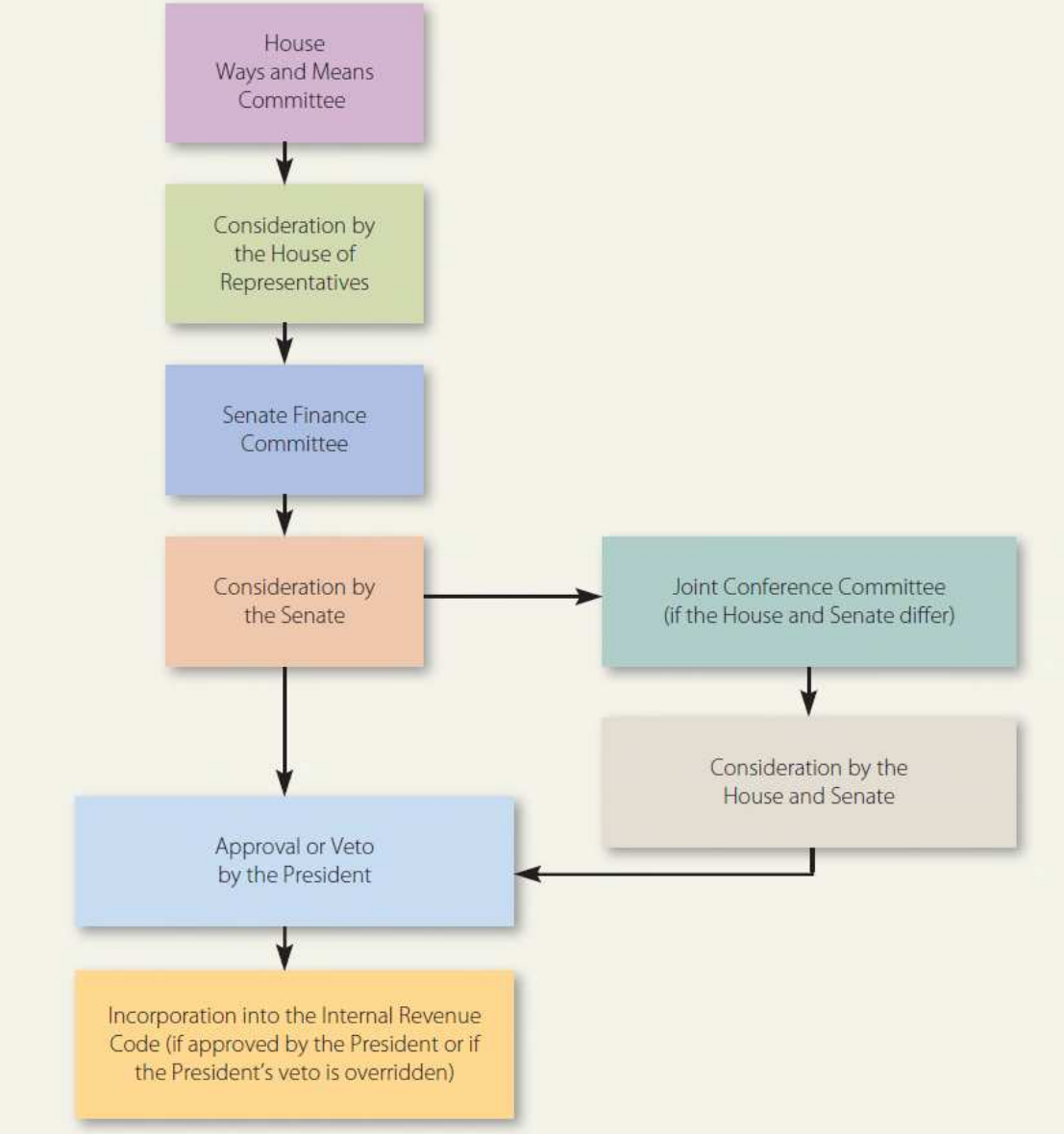


Exhibit 2.1

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Tax Treaties

- The U.S. signs tax treaties with foreign countries to:
  - Avoid double taxation
  - Render mutual assistance in tax enforcement
- Neither a tax law nor a tax treaty takes general precedence
  - When there is a direct conflict, the most recent item will take prevails
  - A taxpayer must disclose on the tax return any position where a treaty overrides a tax law
    - There is a $1,000 penalty per *failure to disclose* for individuals ($10,000 for C corporations)

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Administrative Sources of the Tax Law (slide 1 of 2)

- Treasury Department Regulations
- Revenue Rulings
- Revenue Procedures, and
- Various other administrative pronouncements

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Administrative Sources of Tax Law (slide 2 of 2)

Source	Locations (Selected)	Authority
Regulations	*Federal Register* *Internal Revenue Bulletin*	Force and effect of law. May be cited as precedent.
Temporary Regulations	*Federal Register* *Internal Revenue Bulletin*	May be cited as a precedent.
Proposed Regulations	*Federal Register* *Internal Revenue Bulletin*	Preview of final Regulations. Not yet a precedent.
Revenue Rulings Revenue Procedures Treasury Decisions Actions on Decisions	*Internal Revenue Bulletin*	IRS interpretation only. Weak precedent.
Determination Letters Technical Advice Memoranda	Tax Analysts' *Tax Notes* Thomson Reuters *Checkpoint* Commerce Clearing House *IntelliConnect*	IRS interpretation only. Weak precedent.
Letter Rulings	Thomson Reuters and CCH tax services	Applicable only to taxpayer addressed. May not be cited as precedent.

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Regulations (slide 1 of 4)

- Issued by U.S. Treasury Department
- Provide general interpretations and guidance in applying the Code

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Regulations (slide 2 of 4)

- **Issued as**:
  - Proposed: preview of final regulations
    - Do not have force and effect of law
  - Temporary: issued when guidance needed quickly
    - Same authoritative value as final regulations
  - Final:
    - Force and effect of law

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Regulations (slide 3 of 4)

- Example of Regulation citation:
  - Reg. § 1.2
    - Refers to Regulations under Code § 2
    - Subparts may be added for further identification
    - The numbering patterns of these subparts often have no correlation with the Code subsections

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Regulations (slide 4 of 4)

- Example of Proposed Regulation citation: Prop. Reg. § 1.2
- Example of Temporary Regulation citation: Temp. Reg. § 1.6081–8T

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Revenue Rulings (slide 1 of 2)

- Officially issued by National Office of IRS
  - Provide specific interpretations and guidance in applying the Code
  - Less legal force than Regulations
  - Issued in IRB and accumulated in the Cumulative Bulletins

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Revenue Rulings (slide 2 of 2)

- Example of Revenue Ruling citation
  - Rev. Rul. 2017–16, 2017–35 I.R.B. 215.
    - Explanation: Revenue Ruling Number 16, appearing on page 215 of the 35th weekly issue of the Internal Revenue Bulletin for 2017.

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Revenue Procedures (slide 1 of 2)

- Concerned with the internal management practices and procedures of the IRS
  - Issued similar to Revenue Rulings
  - Issued in IRB and accumulated in the Cumulative Bulletins

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Revenue Procedures (slide 2 of 2)

- Example of an older Revenue Procedure citation
  - Rev. Proc. 92-29, 1992-1 CB 748
    - 29th Rev. Procedure in 1992 found in volume 1 of Cumulative Bulletin on page 748
    - Note: The IRS stopped the publication of Cumulative Bulletins in 2008. All rulings and procedures are now published in Internal Revenue Bulletins, normally issued each week by the IRS.

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Letter Rulings (slide 1 of 2)

- Provide guidance to taxpayer on how a transaction will be taxed before proceeding with it
  - Issued for a fee upon a taxpayer's request
  - Describe how the IRS will treat a *proposed* transaction
- Apply only to the taxpayer who asks for and obtains the ruling
  - Post-1984 letter rulings may be substantial authority for purposes of the accuracy-related penalty
- Limited to restricted, pre-announced areas of taxation

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Letter Rulings (slide 2 of 2)

- Example of Letter Ruling citation
  - Ltr. Rul. 201734004
  - 4th ruling issues in the 34th week of 2017

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Other Administrative Pronouncements
(slide 1 of 3)

- Treasury Decisions - Issued by the Treasury Department to:
  - Promulgate new or amend existing Regulations
  - Announce position of the Government on selected court decisions
  - Published in the Internal Revenue Bulletin

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Other Administrative Pronouncements
(slide 2 of 3)

- Determination Letters
  - Issued by Area Director at taxpayer's request
  - Usually involve completed transactions
  - Not published
    - Made known only to party making the request

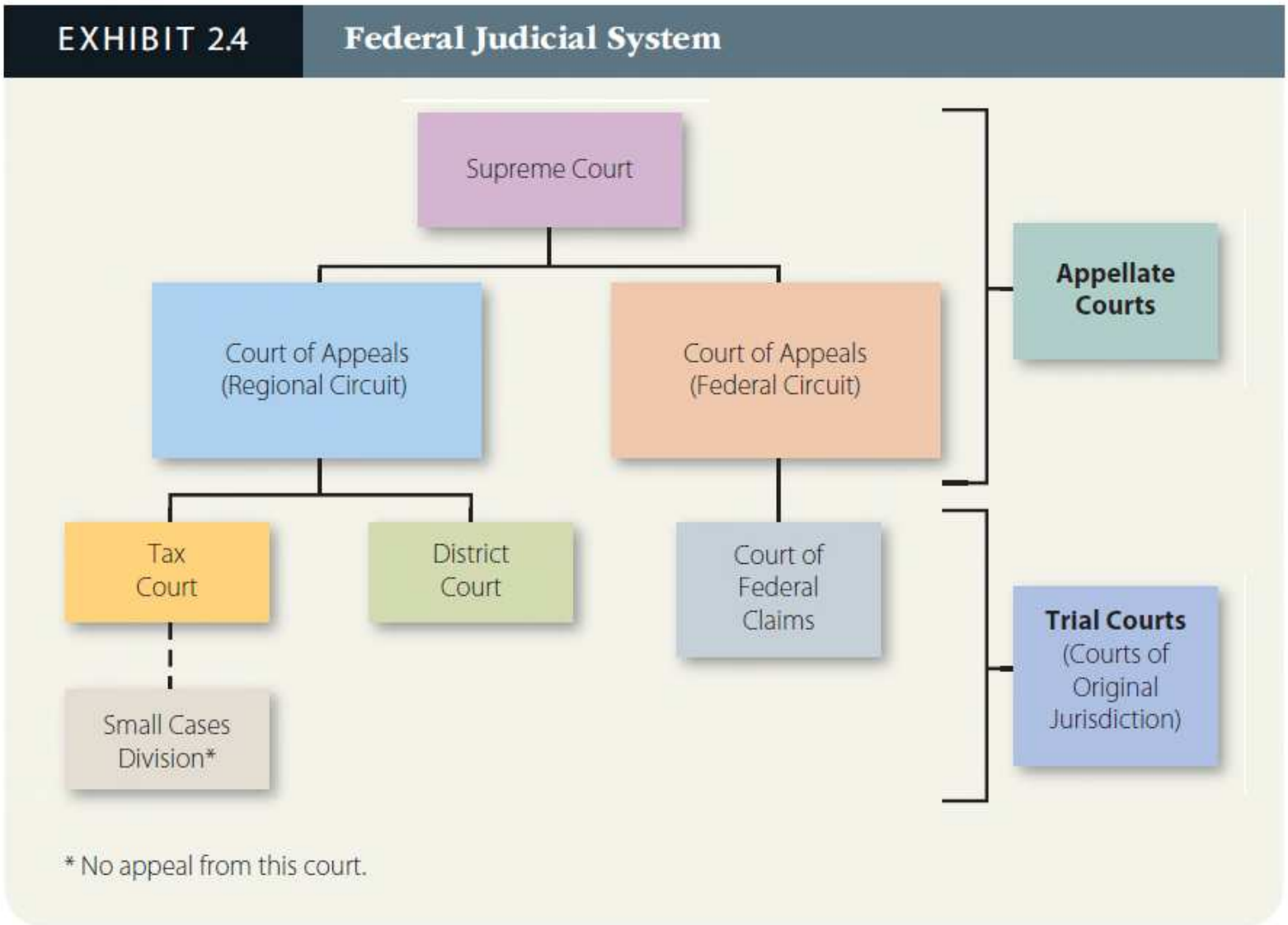
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Other Administrative Pronouncements
(slide 3 of 3)

- A variety of internal memoranda that constitute the working law of the IRS also are released but not officially published, such as
  - General Counsel Memoranda (GCMs)
  - Technical Advice Memoranda (TAMs)
  - Internal Legal Memoranda (ILMs)
  - Field Service Advice Memoranda (FSAs)
- The IRS indicates that they may not be cited as precedents by taxpayers
  - However, these working documents do explain the IRS's position on various issues.

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Federal Judicial System



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Judicial Sources (slide 1 of 2)

- There are four courts of original jurisdiction (trial courts)
  - U.S. Tax Court: Regular
  - U.S. Tax Court: Small Cases Division
  - Federal District Court
  - U.S. Court of Federal Claims

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Judicial Sources (slide 2 of 2)

Concept Summary 2.1

Federal Judicial System: Trial Courts

Issue	Tax Court	District Court	Court of Federal Claims
Number of judges per court	19	1 per case	16
Payment of deficiency before trial	No	Yes	Yes
Jury trial available	No	Yes	No
Types of dispute	Tax cases only	Mostly criminal and civil issues	Claims against the United States
Jurisdiction	Nationwide	Location of taxpayer	Nationwide
IRS acquiescence policy	Yes	Yes	Yes
Appeal is to	U.S. Court of Appeals	U.S. Court of Appeals	Court of Appeals for the Federal Circuit

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Appeals Process

- Appeals from District Court or Tax Court go to the U.S. Court of Appeals for circuit where taxpayer resides
- Appeals from Court of Federal Claims is to Court of Appeals for the Federal Circuit
- Appeal to the Supreme Court is by Writ of Certiorari
  - Only granted for those cases the Supreme Court wants to hear; only a few every year

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Courts' Weights as Precedents

- From high to low
  - Supreme Court
  - Circuit Court of Appeals
  - Tax Court (Regular), U.S. Court of Federal Claims, & U.S. District Courts
- Decisions of the Small Cases Division of the Tax Court have no precedential value and cannot be appealed

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Tax Court (slide 1 of 3)

- Issues two types of decisions: Regular and Memorandum
  - Regular decisions involve novel issues not previously resolved by the court
- Regular decisions are published by the U.S. government, for example

Temporary Citation	*Gerd Topsnik*, 146 T.C. ____, No. 1 (2016). *Explanation:* Page number left blank because not yet known.
Permanent Citation	*Gerd Topsnik*, 146 T.C. 1 (2016). *Explanation:* Page number now available.

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Tax Court (slide 2 of 3)

- Tax Court Memorandum decisions
  - *Memorandum* decisions deal with situations necessitating only the application of already established principles of law
  - Memorandum decisions were not published by the U.S. Government until recently

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Tax Court (slide 3 of 3)

- Memorandum decisions were—and continue to be—published by several tax services
  - Consider, for example, three different ways that *Nick R. Hughes* can be cited:
    - *Nick R. Hughes*, T.C.Memo. 2009–94
      - The 94th Memorandum decision issued by the Tax Court in 2009
    - *Nick R. Hughes*, 97 TCM 1488
      - Page 1488 of Vol. 97 of the CCH Tax Court Memorandum Decisions
    - *Nick R. Hughes*, 2009 RIA T.C.Memo. ¶2009,094
      - Paragraph 2009, 094 of the RIA T.C. Memorandum Decisions

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Examples of District Court Decision Citations

- *Turner v. U.S.*, 2004–1 USTC ¶60,478 (D.Ct. Tex., 2004) (CCH citation)

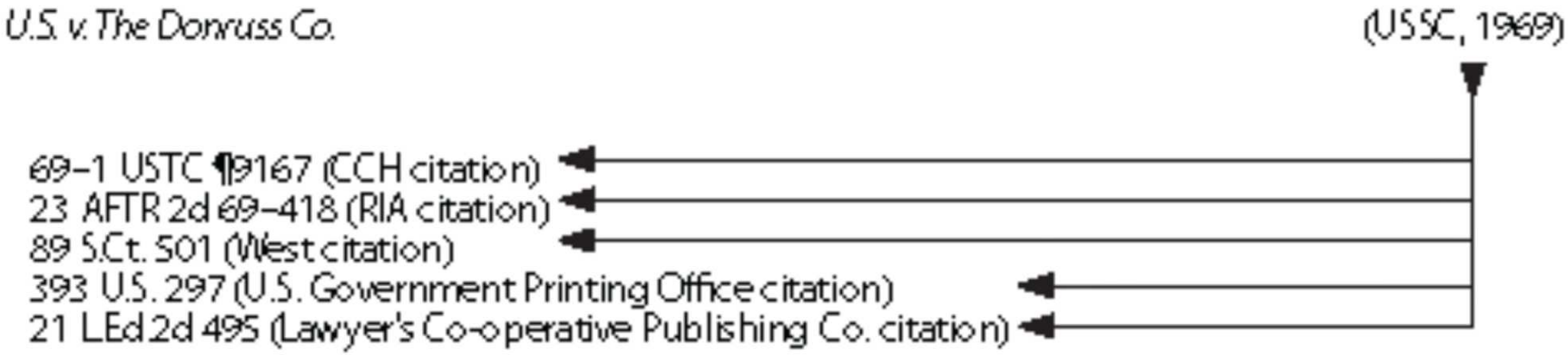
- *Turner v. U.S.*, 93 AFTR 2d 2004–686 (D.Ct. Tex., 2004) (RIA citation)

- *Turner v. U.S.*, 306 F.Supp.2d 668 (D.Ct. Tex., 2004)(West citation)

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Supreme Court Decisions

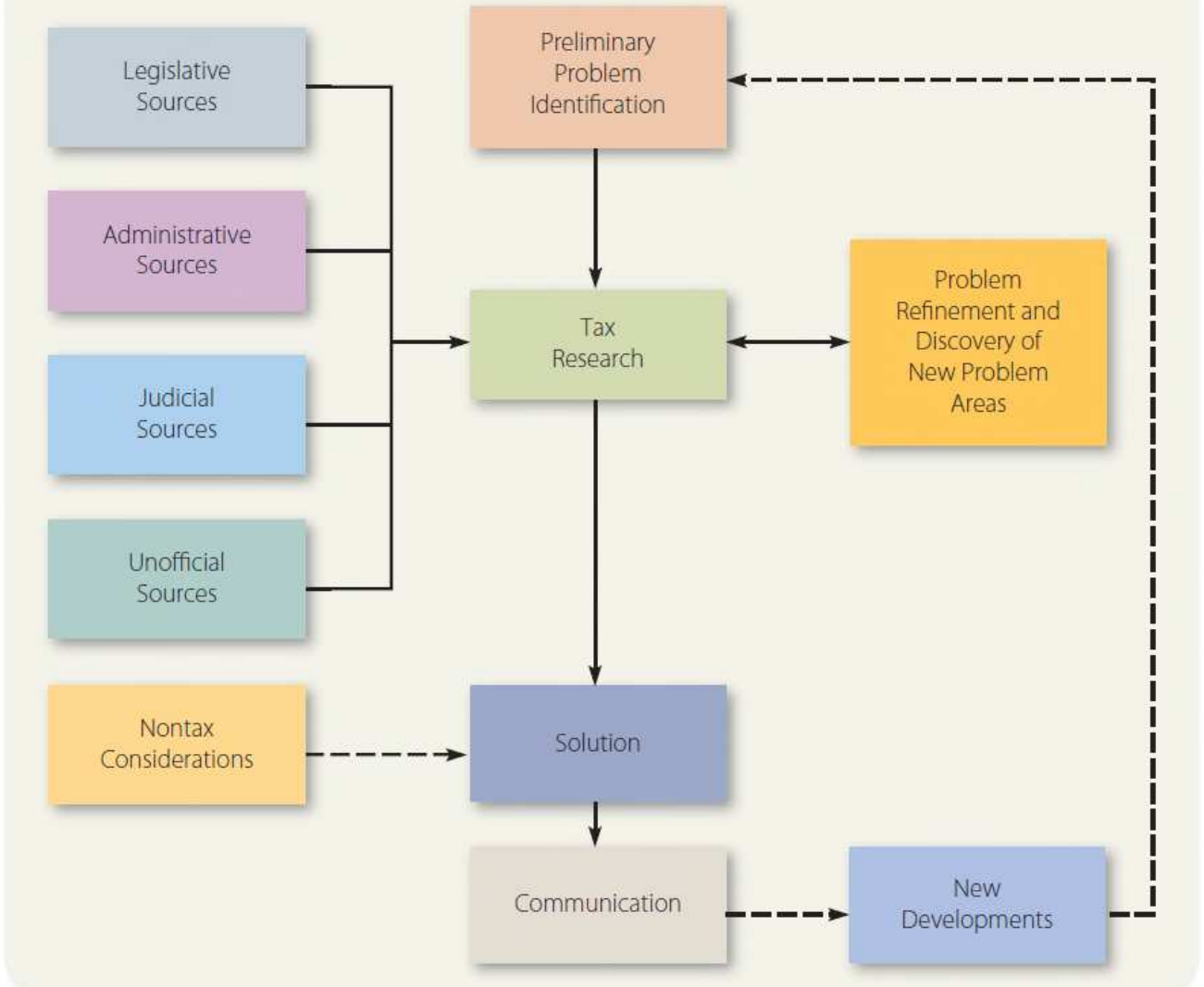
- Examples of citations



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Tax Research Process

EXHIBIT 2.6 Tax Research Process



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Tax Research

- Tax research is the method by which an interested party determines the best solution to a tax situation
- Tax research involves:
  - Identifying and refining the problem
  - Locating the appropriate tax law sources
  - Assessing the validity of the tax law sources
  - Arriving at the solution or at alternative solutions with due consideration given to nontax factors

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Tax Research Tools (slide 1 of 2)

- A crucial part of the research process is the ability to locate appropriate sources of the tax law
  - Both electronic and paper-based research tools are available to aid in this search
- Unless the problem is simple (e.g., the Code Section is known, and there is a Regulation on point), the research process should begin with a tax service

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Tax Research Tools (slide 2 of 2)

- A partial list of the available commercial tax services includes:
  - CCH IntelliConnect, Commerce Clearing House. Includes the Standard Federal Tax Reporter.
  - Thomson Reuters Checkpoint, Research Institute of America. Includes RIA's Federal Tax Coordinator 2d.
  - Parker Tax Pro Library, formerly Kleinrock Tax Expert.
  - Tax Management Portfolios, Bloomberg BNA.
  - Westlaw services, Thomson Reuters. Includes access to Federal Tax Coordinator 2d.
  - TaxCenter, LexisNexis, primary law sources and various materials taken from CCH, Kleinrock, and Bloomberg BNA

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Assessing The Validity Of Tax Law Sources (slide 1 of 4)

- Regulations
  - IRS agents must give the Code and the Regulations equal weight when dealing with taxpayers and their representatives
  - Proposed Regulations are not binding on IRS or taxpayer
  - Burden of proof is on taxpayer to show that a Regulation incorrect
  - If the taxpayer loses the challenge, a 20% negligence penalty may be imposed

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Assessing the Validity of Tax Law Sources (slide 2 of 4)

- Final Regulations tend to be of three types
  - Procedural: housekeeping-type instructions
  - Interpretive: rephrase what is in Committee Reports and the Code
    - Hard to get overturned
  - Legislative: allow the Treasury Department to determine the details of law
    - Congress has delegated its legislative powers and these cannot generally be overturned

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The Big Picture – Example 5
Assessing the Significance of Other Administrative Sources of the Tax Law

- Return to the facts of The Big Picture p. 2-1
- Tax law involving the money found by the Martels is found largely in the Internal Revenue Code and regulations.

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Assessing the Validity of Tax Law Sources (slide 3 of 4)

- Revenue Rulings
  - Carry less weight than Regulations
  - Not substantial authority in court disputes

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Assessing the Validity of Tax Law Sources (slide 4 of 4)

- Judicial sources
  - Consider the level of the court and the legal residence of the taxpayer
  - Tax Court Regular decisions carry more weight than Memo decisions
    - Tax Court does not consider Memo decisions to be binding precedents
    - Tax Court reviewed decisions carry even more weight
  - Circuit Court decisions where certiorari has been requested and denied by the U.S. Supreme Court carry more weight than a Circuit Court decision that was not appealed
  - Consider whether the decision has been overturned on appeal

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The Big Picture – Example 6
Assessing the Significance of Other Administrative Sources of the Tax Law (slide 1 of 3)

- Return to the facts of The Big Picture on p. 2-1.
- The Martels need to know if the gold coins are considered taxable income for them.
  - If yes, they also need to know when to report that income and the amount.
- They share the story with their tax adviser, Jane, a CPA.
  - Jane researches the Martel's questions.

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The Big Picture – Example 6
Assessing the Significance of Other Administrative Sources of the Tax Law (slide 2 of 3)

- What if an appellate court ruling issued by the Federal circuit in which they live supports treatment as $28,000 of income in 2018?
  - Is that decision controlling law?
  - If not and the Martel's circuit has not ruled to the contrary on the issue but another circuit has ruled in their favor in a parallel case, the taxpayers could use that decision as support for their side of the argument.

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The Big Picture – Example 6
Assessing the Significance of Other Administrative Sources of the Tax Law (slide 3 of 3)

- Assume that a Revenue Ruling also is found that supports treating the coins as income in 2018.
  - How long ago were the Revenue Ruling and appellate decision issued?
  - A legal precedent generally is stronger if it was issued more recently.
- If the Martel's circuit has ruled favorably, have other courts discussed the appellate court holding?
  - What did these courts hold?
  - The more courts that follow a holding and cite it favorably, the stronger the legal precedent of the holding.
  - Information of this sort can be found by reviewing the case history of the decision or by consulting a citator.

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Tax Law Sources (slide 1 of 2)

- Primary sources of tax law include:
  - The Constitution
  - Legislative history materials
  - Statutes
  - Treaties
  - Treasury Regulations
  - IRS pronouncements, and
  - Judicial decisions
- In general, the IRS considers only primary sources to constitute substantial authority

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Tax Law Sources (slide 2 of 2)

- Secondary Sources include:
  - Legal periodicals
  - Treatises
  - Legal opinions
  - General Counsel Memoranda, and
  - Written determinations
- In general, secondary sources are not authority

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Taxation on the CPA Examination

- The CPA examination includes tax-oriented questions in the following topical areas. Questions address issues involving tax compliance and tax planning matters.
  - Federal tax procedures, ethics, and accounting issues.
  - Federal taxation of property transactions.
  - Federal taxation—individuals.
  - Federal taxation—entities.

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Refocus on the Big Picture (slide 1 of 5)

- In general, the fair market value of the coins that the Martels discovered must be included in 2018 gross income.
  - This conclusion is based on tax research that you conducted, indicating that the taxpayers having "undisputed possession" of the coins (as of October 2018) creates gross income, under (sec) 61 of the Code, and opinions expressed in U.S. Treasury Department regulations and court cases.

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Refocus on the Big Picture (slide 2 of 5)

- Does it make any difference that the couple paid $195,000 for the land where the coins were buried?
  - Since the couple found the gold coins on their own property, the taxpayers could argue that they purchased the coins when they purchased the land.
    - This argument is similar to an individual discovering oil or natural gas on her property.
    - And with natural resources, there must be a realization event (e.g., a sale or exchange) before there is income.

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Refocus on the Big Picture (slide 3 of 5)

- Would this notion work for this couple?
  - Unfortunately, no.
    - A decision affirmed by the Sixth Circuit Court of Appeals indicates that the entire value of the couple's discovery would be included in their income in the year of discovery.
    - Moreover, the "value" of the assets under the tax law is not the $28,000 face value of the coins.
      - Rather, it is the fair market value of the coins.

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Refocus on the Big Picture (slide 4 of 5)

- Given the potential value of this discovery, your letter to the clients would encourage them to seek out a competent appraiser.
  - Once a determination of the value of the assets is made, you then would work with the clients on a plan to pay the related Federal and state income taxes related to this discovery.

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Refocus on the Big Picture (slide 5 of 5)

What If?

- It is not uncommon that you later will receive additional information from Fred and Megan about their discovery.
  - This may occur if additional facts occur to them, if Fred and Megan gave you incomplete information, or if your original interviews and data collection from them were incomplete.
- If this new information changes the conclusions and recommendations that you already had developed, you should make certain that the taxpayers understand that your original work no longer is valid and that they should not depend on it.

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If you have any comments or suggestions concerning this PowerPoint Presentation for South-Western Federal Taxation, please contact:

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