

Chapter 2

Working with the Tax Law



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LEARNING OBJECTIVES (1 of 2)

LO.1- Distinguish between the statutory, administrative, and judicial sources of the tax law and understand the purpose of each source.

LO.2 - Locate and work with the appropriate tax law sources.

LO.3 - Develop an awareness of tax research tools.

LO.4 - Describe the tax research process.

LO.5 - Communicate the results of the tax research process in a client letter and a tax file memorandum.

LEARNING OBJECTIVES (2 of 2)

LO.6 - Apply tax research techniques and planning procedures.

LO.7 - Be aware of taxation on the CPA examination

The Big Picture (1 of 2)

- Early in November 2020, Fred and Megan Martel scheduled a meeting with you to discuss a potential tax problem
 - Fred and Megan purchased a 40-acre parcel of property in 2015 for \$195,000
 - On it, they built their “dream home” in 2016
 - In March 2020, 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

The Big Picture (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 2020
- Since they are now the rightful owners of the coins, they want to know the tax implications (if any) of their discovery

Statutory Sources of the Tax Law (1 of 2)

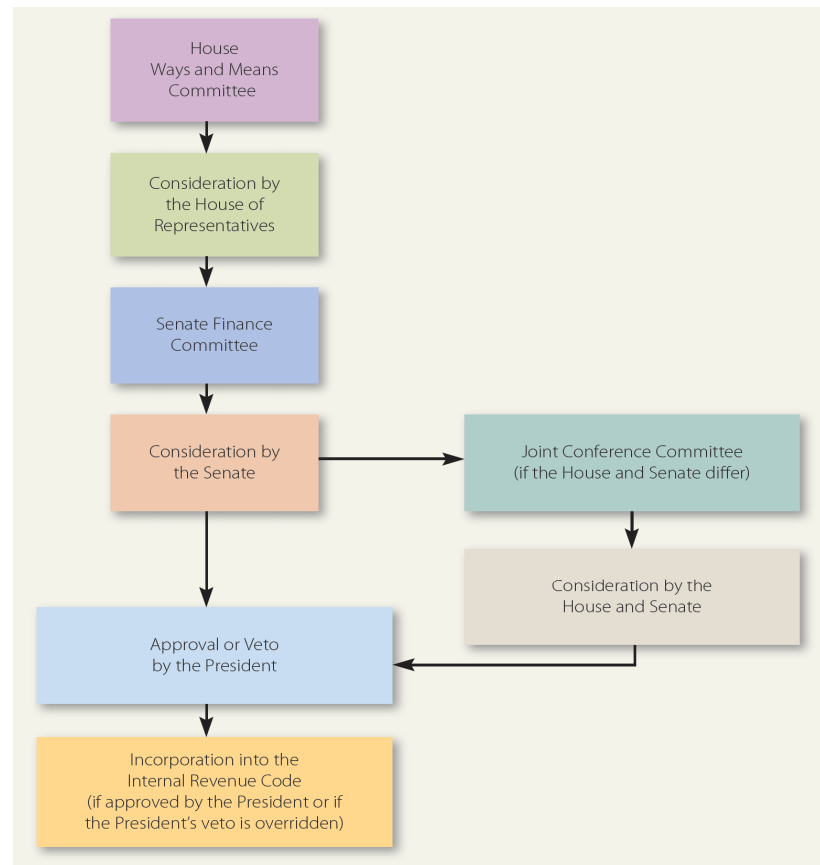
- Constitution (Article I, Sections 7, 8, and 10)
- Tax treaties
 - Agreements between countries to mitigate the double taxation of taxpayers subject to the tax laws of those countries
- Internal Revenue Code
 - Codification of the Federal tax law provisions in a logical sequence and placed them in a separate part of the Federal statutes
 - We have had three “codifications”:
 - 1939, 1954, and 1986

Statutory Sources of the Tax Law (2 of 2)

- Example of Code Citation—§ 2(a)(1)(A)

§	=	Abbreviation for “Section”
2	=	Section number
(a)	=	Subsection designation
(1)	=	Paragraph designation
(A)	=	Subparagraph designation

Legislative Process For Tax Bills



Administrative Sources of the Tax Law

- Treasury Department Regulations
- Revenue Rulings and Revenue Procedures
- Letter Rulings
- Other administrative pronouncements

Administrative Sources (1 of 2)

Source	Location	Authority
Regulations	<i>Federal Register</i>	Force and effect of law
Temporary Regulations	<i>Federal Register</i> <i>Internal Revenue Bulletin</i> <i>Cumulative Bulletin*</i>	May be cited as a precedent
Proposed Regulations	<i>Federal Register</i> <i>Internal Revenue Bulletin</i> <i>Cumulative Bulletin*</i>	Preview of final Regulations
Revenue Rulings	<i>Internal Revenue Bulletin</i>	Do not have the force and effect of law
Revenue Procedures	<i>Cumulative Bulletin*</i>	
Treasury Decisions		
Actions on Decisions		
General Counsel Memoranda	Tax Analysts' <i>Tax Notes</i> ; Thomson Reuters	May not be cited as a precedent
Technical Advice Memoranda	<i>Checkpoint**</i> ; Commerce Clearing House <i>IntelliConnect</i>	
Letter Rulings	Thomson Reuters and Commerce Clearing House tax services	Applicable only to taxpayer addressed No precedential force

Administrative Sources (2 of 2)

*Through 2008, the contents of *Internal Revenue Bulletins* were consolidated semiannually into a *Cumulative Bulletin*. Beginning in 2009, the IRS stopped producing a *Cumulative Bulletin* because all *Internal Revenue Bulletins* are available electronically on the IRS website (irs.gov)

**Thomson Reuters *Checkpoint* includes a wide variety of tax resources. The most significant are materials produced by the Research Institute of America (RIA), including the *Federal Tax Coordinator 2d*

Regulations (1 of 4)

- Issued by U.S. Treasury Department
- Provide considerable guidance on the meaning and application of the Code

Regulations (2 of 4)

- Issued in
 - 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 and may be cited as precedents
 - Final – Issued as Treasury Decisions (T Ds)
 - Force and effect of law

Regulations (3 of 4)

- Example of Proposed Regulation citation:
 - Prop. Reg. § 1.2
- Example of Temporary Regulation citation:
 - Temp. Reg. §

Regulations (4 of 4)

- Regulations also may be classified as
- Example of Proposed Regulation citation:
 - Legislative
 - Interpretive
 - procedural

Revenue Rulings and Revenue Procedures (1 of 4)

- Revenue rulings
 - Official pronouncements of the National Office of the IRS
 - Provide one or more examples of how the IRS would apply a law to specific fact situations
 - Published weekly in the *Internal Revenue Bulletin* (I.R.B.) by the U.S.
 - Provide guidance to IRS personnel and taxpayers in handling routine tax matters

Revenue Rulings and Revenue Procedures (2 of 4)

- Example of Revenue Ruling citation
 - Rev. Rul. 2019–13, 2019–20 I.R.B. 1179
 - Explanation: Revenue Ruling Number 13, appearing on page 1179 of the 20th weekly issue of the *Internal Revenue Bulletin* for 2019

Revenue Rulings and Revenue Procedures (3 of 4)

- Revenue procedures
 - Deal with the internal management practices and procedures of the IRS
 - Published weekly in the *Internal Revenue Bulletin* (I.R.B.) by the U.S. Government
 - Provide guidance to IRS personnel and taxpayers in handling routine tax matters

Revenue Rulings and Revenue Procedures (4 of 4)

- Example of Revenue Procedure citation
 - Rev. Proc. 2020–1 (2020–1 I.R.B. 1)

Letter Rulings (1 of 2)

- Offer guidance to taxpayer on how a transaction will be taxed before proceeding with it
 - Issued for a fee upon a taxpayer's request by the national office of the IRS
 - Describe how the IRS will treat a proposed transaction for tax purposes
- Limits the issuance of individual rulings to restricted, preannounced areas of taxation

Letter Rulings (2 of 2)

- Example of Letter Ruling citation
 - Ltr.Rul. 201933005
 - 5th ruling issued during the 33rd week of 2019

Other Administrative Pronouncements (1 of 4)

- Treasury Decisions (TDs) – Issued by the Treasury Department to:
 - Announce new regulations
 - Amend or change existing regulations
 - Announce the position of the Government on selected court decisions
- TDs are published in the *Internal Revenue Bulletin*

Other Administrative Pronouncements (2 of 4)

- Determination Letters
 - Issued by an IRS Area Director at taxpayer's request
 - Provide guidance on the application of the tax law
 - Usually involve completed transactions
 - Not published
 - Made known only to the party making the request

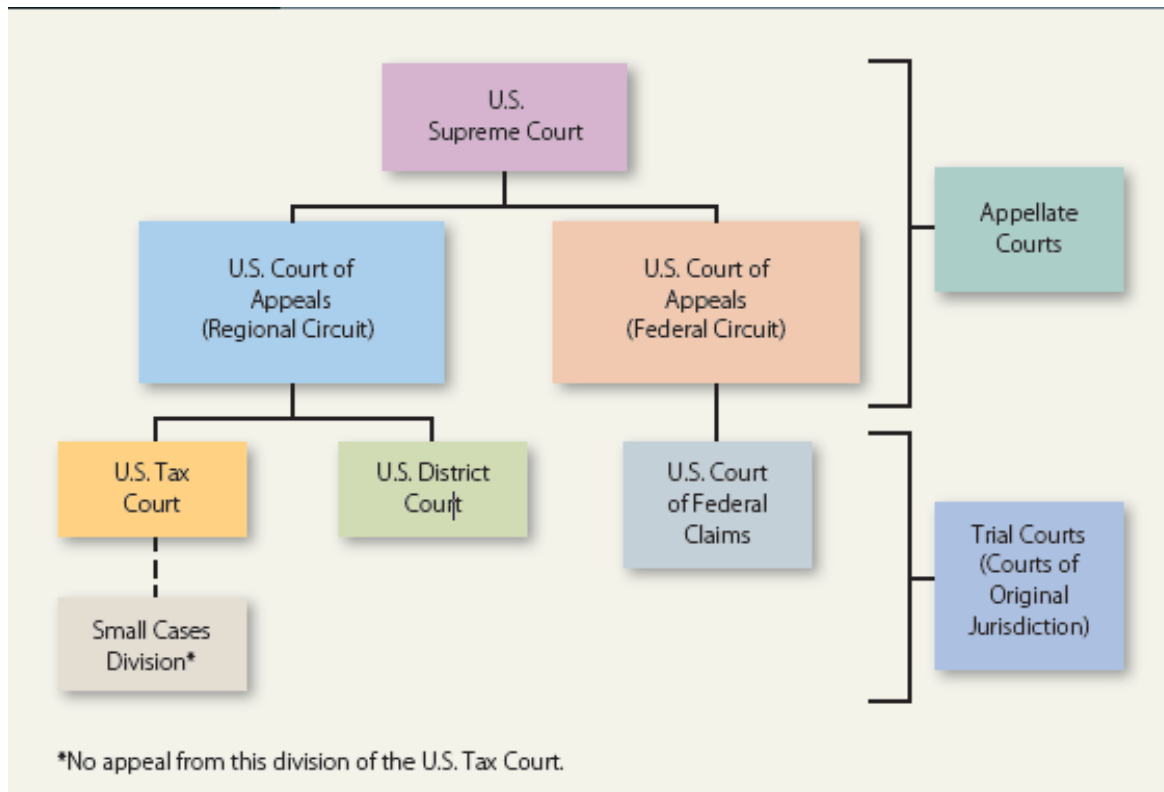
Other Administrative Pronouncements (3 of 4)

- 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.

Other Administrative Pronouncements (4 of 4)

- Technical advice memoranda (TAMs)
 - resembles letter rulings that give the IRS's determination of an issue
 - deal with completed (rather than proposed) transactions
 - is issued by the national office of the IRS
 - purpose is to expedite legal guidance to field agents

Federal Judicial System



Judicial Sources of the Tax Law (1 of 7)

- There are 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
 - The U.S. Supreme Court

Judicial Sources of the Tax Law (2 of 7)

- There are three courts of original jurisdiction (trial courts)
 - U.S. Tax Court
 - Small Cases Division – only hears cases involving amounts of \$50,000 or less
 - U.S. District Court
 - U.S. Court of Federal Claims

Judicial Sources of the Tax Law (3 of 7)

- Important terms to understand
 - The plaintiff is the party requesting a hearing
 - The defendant is the party being challenged
 - Sometimes court uses the terms petitioner and respondent (rather than plaintiff and defendant)

Judicial Sources of the Tax Law (4 of 7)

- Difference between various trial courts are by:
 - Number of courts
 - Number of judges
 - Location
 - Jurisdiction of the Tax Court and District Courts
 - Jurisdiction of the Court of Federal Claims
 - Jury trial
 - Payment of deficiency
 - Appeals
 - Bankruptcy
 - Gray areas

Judicial Sources of the Tax Law (5 of 7)

Federal Judicial System: Trial Courts

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

Judicial Sources of the Tax Law (6 of 7)

*Currently, there are only 15 regular judges. They are assisted by 11 senior judges (whose terms have ended, but return to hear cases as needed) and 4 special trial judges (who are appointed by the Senior Judge of the U.S. Tax Court, rather than by the President) (January 2020)

Judicial Sources of the Tax Law (7 of 7)

- Appellate Courts
 - Trial court decision can be appealed to the appropriate Circuit Court of Appeals
 - A three-judge panel hears a Court of Appeals case, but occasionally the full court decides more controversial cases

The Appellate Process

- The role of the appellate court is limited to a review of whether the trial court applied the proper law in arriving at its decision
- 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 go 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

Judicial Citations - The U.S. Tax Court (1 of 3)

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

Temporary Citation { *Renee Vento, et al.*, 152 T.C. , No. 1 (2019).
Explanation : Page number left blank because not yet know

Permanent Citation { *Renee Vento, et al.*, 152 T.C. 1 (2019).
Explanation : Page number now available.

- Summary opinions
 - Issued in small tax cases and may not be used as precedent in any other case

Judicial Citations - The U.S. Tax Court (2 of 3)

- Tax Court Memorandum decisions
 - Memorandum decisions deal with cases that involve only the application of already established principles of law
 - Memorandum decisions are available on the U.S. tax court website

Judicial Citations - The U.S. Tax Court (3 of 3)

- Memorandum decisions are published by both CCH and RIA
 - Consider, for example, the three different ways the Nick R. Hughes case 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 T C M 1488
 - Page 1488 of Vol. 97 of the C C H *Tax Court Memorandum Decisions*
 - Nick R. Hughes, 2009 R I A T.C.Memo. ¶2009,094
 - Paragraph 2009,094 of the R I A *T.C. Memorandum Decisions*

Judicial Citations – The U.S. District Court, Court of Federal Claims, and Court of Appeals (1 of 3)

- District Court, Court of Federal Claims, Court of Appeals, and Supreme Court decisions dealing with Federal tax matters are reported in both the CCH *U.S. Tax cases* (USTC) and the RIA *American Federal Tax Reports* (AFTR) series
- U.S. District Court decisions, dealing with both tax and nontax issues, also are published by West in its *Federal Supplement Second Series*

Judicial Citations – The U.S. District Court, Court of Federal Claims, and Court of Appeals (2 of 3)

- Examples of District Court case 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)

Judicial Citations – The U.S. District Court, Court of Federal Claims, and Court of Appeals (3 of 3)

- Examples of citations of Court of Federal Claims

U.S. v. The Donruss Co.

(USSC, 1969)

69–1 USTC ¶19167 (CCH citation)

23 AFTR 2d 69–418 (RIA citation)

89 S.Ct. 501 (West citation)

393 U.S. 297 (U.S. Government Printing Office citation)

21 L.Ed.2d 495 (Lawyer’s Co-operative Publishing Co. citation)

Tax Treaties

- The U.S. signs tax treaties with foreign countries to:
 - Avoid double taxation
- When there is a direct conflict between the code and a treaty, the most recent item will take precedence

Working with the Tax Law - Tax Research Tools (1 of 5)

- Tax law consist of a body of
 - Legislative (e.g., code sections and tax treaties)
 - Administrative (e.g., regulations and rulings)
 - Judicial (e.g., court cases)
- Working with the tax law requires being able to locate and use these sources effectively
- Unless the problem is simple (for example, the Code Section is known and there is a Regulation on point), the research process begins with a tax service

Working with the Tax Law - Tax Research Tools (2 of 5)

- The research process begins with tax service
 - Commercial tax services
 - Electronic tax (online) services
 - Noncommercial electronic tax (online) services

Working with the Tax Law - Tax Research Tools (3 of 5)

- Commercial tax services
- Here is a partial list of the available commercial tax services:
 - *Standard Federal Tax Reporter*, Commerce Clearing House
 - *CCH IntelliConnect*, Commerce Clearing House online service
 - *United States Tax Reporter*, Research Institute of America, Thomson Reuters
 - Thomson Reuters *Checkpoint*, Research Institute of America
 - *Practical Tax Expert*, CCH/Wolters Kluwer
 - *Tax Management Portfolios*, Bloomberg BNA
 - *Mertens Law of Federal Income Taxation*, Thomson Reuters
 - *Westlaw* and *WestlawNext*, Thomson Reuters
 - *Tax Center*, LexisNexis

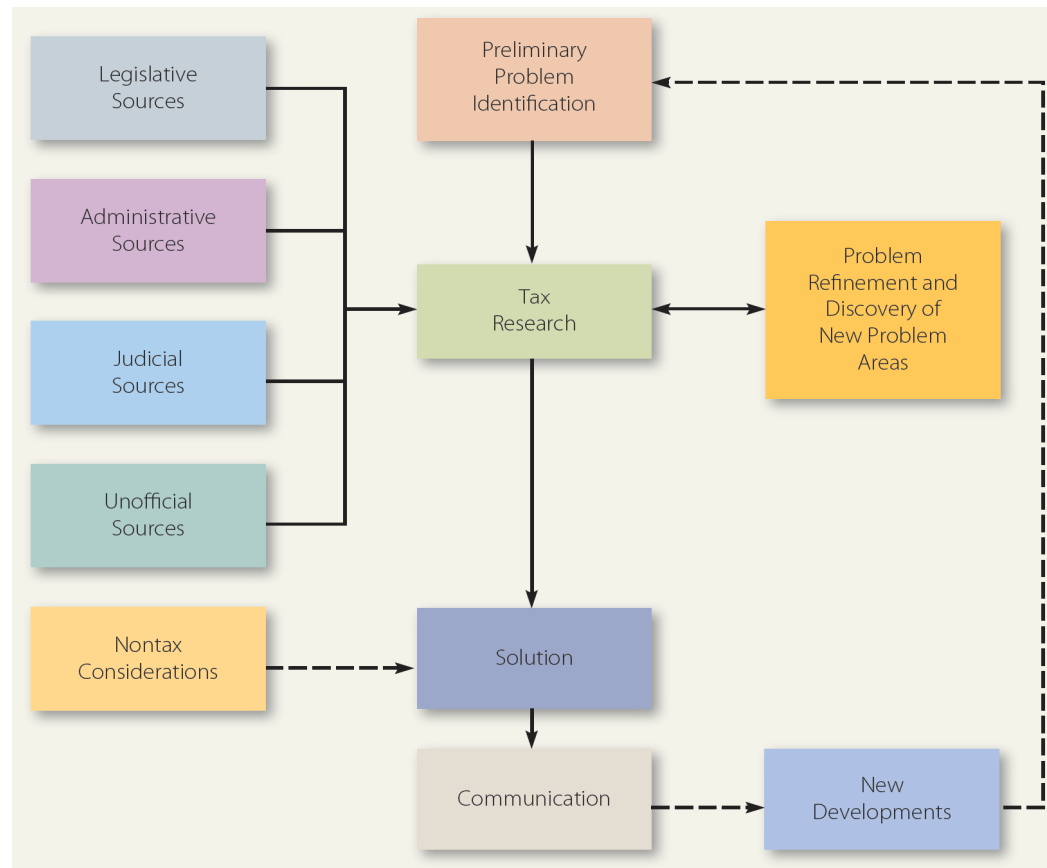
Working with the Tax Law - Tax Research Tools (4 of 5)

- Electronic (online) tax services
 - Competent tax professional must become familiar and proficient with electronic research services
 - Certain general procedures
 - Carefully choose keywords for the research
 - Take advantage of connectors
 - Be selective in choosing the data to search
 - Use a table of contents, an index, or a citation when appropriate

Working with the Tax Law - Tax Research Tools (5 of 5)

- Noncommercial electronic (online) tax services
 - Internet provides a wealth of tax information in many popular forms
 - Websites are provided by accounting and consulting firms etc.,
 - Blogs and RSS sites provide a means by which information related to the tax law can be exchanged among taxpayers, tax professionals etc.,

Tax Research Process



Working with the Tax Law - Tax Research

- Tax research is the process of finding a competent and professional conclusion to a tax problem
- 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
 - Effectively communicating the solution to the taxpayer
 - Updating the solution (where appropriate) in light of new developments

Assessing the Validity of Tax Law Sources (1 of 6)

- Treasury 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 is incorrect
 - If the taxpayer loses the challenge, a 20% negligence penalty may be imposed

Assessing the Validity of Tax Law Sources (2 of 6)

- Final Regulations tend to be of three types
 - Procedural – “Housekeeping-type” instructions
 - Interpretive – Rephrase or elaborate 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

Assessing the Validity of Tax Law Sources (3 of 6)

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

Assessing the Validity of Tax Law Sources (4 of 6)

- Judicial sources
 - Consider the level of the court and the legal residence of the taxpayer
 - Tax Court Regular decisions carry more weight than Memorandum decisions
 - Tax Court does not consider Memorandum 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

Assessing the Validity of Tax Law Sources (5 of 6)

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

Assessing the Validity of Tax Law Sources (6 of 6)

- Secondary Sources include:
 - Legal periodicals
 - Treatises
 - Legal opinions
 - IRS publications
 - Other materials
- In general, secondary sources are not authority

Working with the Tax Law - Tax Planning (1 of 2)

- The primary purpose of effective tax planning is to maximize the taxpayer's after-tax wealth
 - Must consider the legitimate business goals of taxpayer
- A secondary objective of effective tax planning is to reduce, defer, or eliminate the tax
- Tax avoidance versus tax evasion
 - Tax avoidance is the legal minimization of tax liabilities and one goal of tax planning
 - Tax evasion is the illegal minimization of tax liabilities
 - Suggests the use of subterfuge and fraud as a means to tax minimization
 - Can lead to fines and jail

Working with the Tax Law - Tax Planning (2 of 2)

- This objective aims to accomplish:
 - Eliminating the tax entirely
 - Eliminating the tax in the current year
 - Deferring the receipt of income
 - Converting ordinary income into capital gains
 - Converting active income into passive active income
 - Converting passive activity expense to active expense
 - Increasing the number of taxpayers
 - Eluding double taxation
 - Avoiding ordinary income
 - Creating, increasing or accelerating deductions

Taxation on the CPA Examination

- CPA exam test in the familiar four sections – Auditing and Attestations (AUD), Business Environment and Concepts (BEC), Financial Accounting and Reporting (FAR), and Regulation (REG)
- Total testing time is 16 hours (4 hours per section)
- Taxation is included in the 4-hour Regulation section
- Knowledge is tested using both multiple-choice questions and task-based simulations