

CHAPTER 2

WORKING WITH THE TAX LAW

SOLUTIONS TO PROBLEM MATERIALS

Question/ Problem	Learning Objective	Topic	Status: Present Edition	Q/P in Prior Edition
1	LO 1	Intent of Congress	Unchanged	1
2	LO 1	Alternatives for structuring a business transaction	Unchanged	2
3	LO 1	Tax Freedom Day	Unchanged	3
4	LO 1	Tax legislation originates	Unchanged	4
5	LO 1	Title 26 of the U.S. Code in Subtitle A	Unchanged	5
6	LO 2, 5	Treaties	Unchanged	6
7	LO 1, 2	Regulation citation	Unchanged	7
8	LO 1, 2	Regulations	Unchanged	8
9	LO 1, 4	Types of Regulations	Unchanged	9
10	LO 1	Revenue Ruling citation	Unchanged	10
11	LO 1, 4	Authority	Unchanged	11
12	LO 1	Citations	Unchanged	12
13	LO 1	Letter Rulings	New	
14	LO 1	Using the judicial system	Unchanged	13
15	LO 1	Small Cases Division	Unchanged	14
16	LO 1, 5	Judicial alternatives: trial courts	Unchanged	16
17	LO 1	U.S. Tax Court	Unchanged	17
18	LO 1	Judicial system	Unchanged	18
19	LO 1	Circuit Court of Appeals	Unchanged	21
20	LO 1	Precedents of courts	New	
21	LO 1, 4	Court decision validity	Unchanged	23
22	LO 2	Citation	New	
23	LO 2	Appeal to U.S. Supreme Court	Unchanged	24
24	LO 2	Citation	New	
25	LO 2	Citations	Unchanged	25
26	LO 1, 2	Abbreviations	Unchanged	26
27	LO 2	Commerce Clearing House citations	Unchanged	27
28	LO 2	Location of decision of U.S. Court of Federal Claims	New	
29	LO 3	Tax research	Modified	29
30	LO 6	Primary purpose of tax planning	Unchanged	30
31	LO 7	CPA exam	Unchanged	31
32	LO 1	Subchapters	Unchanged	32

<u>Question/ Problem</u>	<u>Learning Objective</u>	<u>Topic</u>	<u>Status: Present Edition</u>	<u>Q/P in Prior Edition</u>
33	LO 1	Authority	Unchanged	34
34	LO 4	Tax sources	New	
35	LO 1, 2	Publishers' citations	Unchanged	35
36	LO 6	Tax avoidance versus tax evasion	Unchanged	36

<u>Research Problem</u>	<u>Topic</u>	<u>Status: Present Edition</u>	<u>Q/P in Prior Edition</u>
1	Citations	Unchanged	1
2	Reliability	Unchanged	2
3	Library research	New	
4	Internet activity	Unchanged	3
5	Internet activity	New	

Proposed solutions to the **Research Problems** are found in the Instructor's Guide.

DISCUSSION QUESTIONS

1. Determining the intent of Congress is a large part of tax research.
2. The many gray areas, the complexity of the tax laws, and the possibility for different interpretations of the tax law create the necessity of alternatives for structuring a business transaction.
3. “Tax Freedom Day” for 2013 occurred on April 18, 2013.
4. Federal tax legislation generally originates in the House Ways and Means Committee.
5. The income tax laws are found in Title 26 of the U.S. Code in Subtitle A.

6.

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

March 22, 2014

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

Dear Mr. Bishop:

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

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

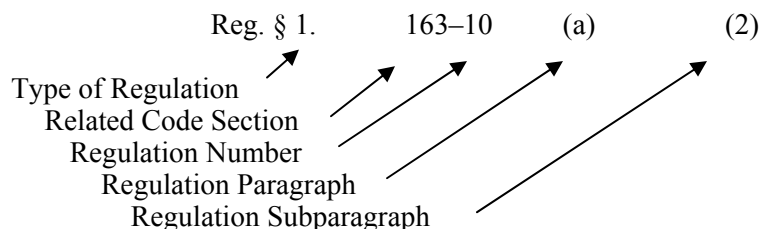
A taxpayer must disclose on the tax return any positions where a treaty overrides a tax law. There is a \$1,000 penalty per failure to disclose for individuals and a \$10,000 penalty per failure for corporations.

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

Sincerely,

Alice Hanks, CPA
Tax Partner

7. Income tax



8. Because Regulations interpret the Code, they are arranged in the same sequence as the Code. Regulations are prefixed by a number that designates the type of tax or administrative, procedural, or definitional matter to which they relate. These Regulations would be cited as follows with subparts added for further identification. The subparts have no correlation with the subsections in the Code.
- Reg. § 1.152.
 - Prop.Reg. § 1.274.
 - Temp.Reg. § 1.163.
 - Reg. § 1.1501.
9. In many Code sections, Congress has given to the “Secretary or his delegate” the authority to prescribe Regulations to carry out the details of administration or otherwise to complete the prevailing administrative rules. Under such circumstances, it almost could be said that Congress is delegating its legislative powers to the Treasury Department. Regulations that are issued pursuant to this type of authority truly possess the force and effect of law and often are called legislative Regulations. Examples of legislative Regulations include those that address consolidated returns issued under §§ 1501 through 1505 and those that addressed the debt/equity question issued under § 385 (withdrawn).
- Legislative Regulations are to be distinguished from interpretive Regulations, which purport to rephrase and elaborate on the meaning (i.e., intent of Congress) of a particular Code Section. An example of interpretive Regulations are those issued under § 1031 for like-kind exchanges.
- Procedural Regulations are “housekeeping-type” instructions indicating information that taxpayers should provide to the IRS as well as information about the management and conduct of the IRS itself.
- The need to distinguish between these three types of Regulations relates to their validity as a tax law source.
10. Notice 90–20 is the 20th Notice issued during 1990, and it appears on page 328 of Volume 1 of the Cumulative Bulletin in 1990.
11. The items would probably be ranked as follows (from lowest to highest):
- Letter ruling (valid only to the taxpayer to whom issued).
 - Proposed Regulation (most courts ignore these).
 - Revenue Ruling.
 - Interpretive Regulation.
 - Legislative Regulation.
 - Internal Revenue Code.
12. a. This is a Temporary Regulation; 1 refers to the type of Regulation (i.e., income tax), 956 is the related Code section number, 2 is the Regulation section number, and T refers to temporary.
- b. Revenue Ruling number 15, appearing on page 975 of the 23rd weekly issue of the *Internal Revenue Bulletin* for 2012.
- c. Letter Ruling 51, issued in the 4th week of 2002.

13. TAX FILE MEMORANDUM

September 23, 2014

FROM: George Ames

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

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

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

14. Dwain must consider several factors in deciding whether to take the dispute to the judicial system:

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

15. a. No. There is no appeal from the Small Cases Division.
- b. No. Deficiency cannot exceed \$50,000.
- c. Yes.
- d. No. However, decisions are now published on the Tax Court's website.
- e. Yes.
- f. Yes.

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

July 8, 2014

Mr. Eddy Falls
200 Mesa Drive
Tucson, AZ 85714

Dear Mr. Falls:

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

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

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

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

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

Sincerely,

Agnes Reynolds, CPA
Tax Partner

17. The U.S. Tax Court hears only tax cases and is the most popular forum for tax cases (generally viewed as an advantage). Some people suggest that the Tax Court has more expertise in tax matters. A taxpayer does not have to pay the tax deficiency assessed by the IRS before trial, but a taxpayer may deposit a cash bond to stop the running of interest (also viewed as an advantage). Appeals from a Tax Court are to the appropriate U.S. Court of Appeals. A disadvantage is that the taxpayer may not obtain a jury trial in the U.S. Tax Court.
18. See Figure 2.3, Figure 2.4, and Concept Summary 2.1.
- 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.
 - 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 b. above.
 - d. The appeal would be to the Federal Circuit Court of Appeals and then to the U.S. Supreme Court.
19. See Figure 2.4.
- a. 10th.
 - b. 8th.
 - c. 9th.
 - d. 5th.
 - e. 7th.
20. See Figure 2.3.
- 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.
- 21.
- a. If the taxpayer chooses a U.S. District Court as the trial court for litigation, the U.S. District Court of Wyoming will be the forum to hear the case. Unless the prior decision has been reversed on appeal, one would expect the same court to follow its earlier holding.
 - b. If the taxpayer chooses the U.S. Court of Federal Claims as the trial court for litigation, the decision that was rendered previously by this Court should have a direct bearing on the outcome. If the taxpayer selects a different trial court (i.e., the appropriate U.S. District Court or the U.S. Tax Court), the decision that was rendered by the U.S. Court of Federal Claims will be persuasive, but not controlling. It is, of course, assumed that the result that was reached by the U.S. Court of Federal Claims was not reversed on appeal.
 - c. The decision of a U.S. Circuit Court of Appeals will carry more weight than will one that was rendered by a trial court. Because the taxpayer lives in California, however, any appeal from a U.S. District Court or the U.S. Tax Court will go to the Ninth Circuit Court of Appeals (see Figure 2.3). 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 Figure 2.4.
 - d. Because the U.S. Supreme Court is the highest appellate court, one can place complete reliance upon its decisions. Nevertheless, one should investigate any decision to see whether the Code has been modified with respect to the result that was reached. There also exists the rare possibility that the Court may have changed its position in a later decision. See Figure 2.3.

- e. When the IRS acquiesces to a decision of the U.S. Tax Court, it agrees with the result that was reached. As long as such acquiescence remains in effect, taxpayers can be assured that this represents the position of the IRS on the issue that was involved. Keep in mind, however, that the IRS can change its mind and can, at any time, withdraw the acquiescence and substitute a nonacquiescence.
 - f. The issuance of a nonacquiescence usually reflects that the IRS does not agree with the result that was reached by the U.S. Tax Court. Consequently, taxpayers are placed on notice that the IRS will continue to challenge the issue that was involved.
22. 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.
23. 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*).
- 24.
- 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.
25. See Concept Summary 2.2.
- a. This citation is to a regular decision of the U.S. Tax Court that was issued in 1950. The decision can be found in Volume 14, page 74, of the Tax Court of the United States Report, published by the U. S. Government Printing Office.
 - b. This citation is for a decision of the U.S. Fifth Circuit Court of Appeals that was rendered in 1979. The decision can be found in Volume 592, page 1251, of the Federal Reporter, Second Series (F. 2d), published by West Publishing Company.
 - c. This citation is for a decision of the U.S. Sixth Circuit Court of Appeals that was rendered in 1995. The decision can be found in Volume 1 for 1995, paragraph 50,104 of U.S. Tax Cases, published by Commerce Clearing House.
 - d. This citation is for a decision of the U.S. Sixth Circuit Court of Appeals that was rendered in 1995. The decision can be found in Volume 75, page 110, of the Second Series of American Federal Tax Reports, published by RIA.
 - e. This citation is for a decision of the U.S. District Court of Texas that was rendered in 1963. The decision can be found in Volume 223, page 663, of the Federal Supplement Series, published by West Publishing Company.

26. 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.
- 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.
27. a. None.
- b. USTC.
- c. USTC.
- d. USTC.
- e. TCM.

28. Decisions of the U.S. Court of Federal Claims (formerly named the Claims Court) are published in the USTCs; AFTRs; and the West Publishing Co. reporter called the Federal Reporter, Second Series (F.2d) (before October 1982) and Claims Court Reporter (beginning October 1982 through October 30, 1992). The name of the U.S. Court of Federal Claims was changed from the Claims Court effective October 30, 1992. Currently, this court's decisions are published in the Federal Claims Reporter. See Concept Summary 2.2.
29. After understanding the relevant facts:
- Yvonne may begin with the index volumes of the available tax services: RIA, CCH, BNA Portfolios, etc.
 - A key word search on an online service could be helpful—WESTLAW, LEXIS, CCH, and RIA Checkpoint.
 - Yvonne may employ a key word search of a CD-ROM and browse through a tax service, IRS publications, etc. West Publishing, CCH, Kleinrock, and RIA offer CD-ROM products.
 - Yvonne could consult CCH's Federal Tax Articles to locate current appropriate articles written about child support payments. RIA's Tax Service also has a topical "Index to Tax Articles" section that is organized using the RIA paragraph index system.
 - Yvonne may consult The Accounting & Tax Index, which is available in three quarterly issues and a cumulative year-end volume covering all four quarters.
 - Up-to-date information may be found on the Web. Various legal, accounting, and financial gateways can be found by clicking on highlighted words or phrases.
30. The primary purpose of tax planning is to reduce a taxpayer's overall tax liability. This process can entail an avoidance, a reduction, or a postponement of the tax until the future.
- This process does not mean that the course of action selected must produce the lowest possible tax under the circumstances. Legitimate business goals also must be considered.
- There is nothing illegal or immoral about tax avoidance. A citizen has every legal right to arrange his or her affairs 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 difference between a tax adviser's reduction of a tax expense and a cost accountant's reduction of a cost of operating a business.
31. Simulations on the CPA exam are small case studies designed to test a candidate's tax knowledge and skills using real-life work-related situations. Simulations include a four-function pop-up calculator, a blank spreadsheet with some elementary functionality, and authoritative excerpts that are necessary to complete the tax case study simulations (e.g., Internal Revenue Code and Federal tax forms).

PROBLEMS

32. b. p. 2-5
33. a. Code section.
b. Legislative Regulation.
c. Recent Temporary Regulation.
d. Interpretive Regulation.
e. Revenue Ruling.
f. Letter Ruling.
g. Proposed Regulation.
See Exhibit 2.1.
34. a. P.
b. P.
c. P.
d. S.
e. P.
f. S.
g. P. Valid for three years.
h. P.
i. N.
j. P.
35. a. CCH.
b. RIA.
c. U.S.
d. CCH.
e. U.S.
f. RIA.
g. W.
h. W.

- i. W.
- j. W.
- k. U.S.
- l. O.
- 36. a. E.
- b. E.
- c. A.
- d. A.
- e. A.

SOLUTIONS TO ETHICS & EQUITY FEATURES

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

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

Global Poverty Saint Should Pay Up! (p. 2-36). Moving his U2 band’s operations to Holland to save taxes is, of course, tax avoidance and not tax evasion. But the Irish Exchequer is losing millions of euros.

The real problem is Bono’s 9.6 million pound nonprofit organization’s paltry 1.2% payments to good causes. An article entitled “Saint Bono” on the website Not a Sheep dated September 24, 2010, indicated that *New York Post* figures show that 5.1 million pounds went to salaries. The story asked why, with “Bono’s predilection for campaigning for an end of the world poverty,” the BBC and other media did not spotlight these stories.

Source: Adapted from “Saint Bono,” Not a Sheep, September 24, 2010, <http://notasheepmaybeagoat.blogspot.com/2010/09/saint-bono.html>.