

SOLUTIONS MANUAL



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SOUTH-WESTERN
FEDERAL TAXATION



2009
6009

Taxation of Business Entities

Smith / Raabe / Maloney

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CHAPTER 2
WORKING WITH THE TAX LAW
SOLUTIONS TO PROBLEM MATERIALS

Question/ Problem	Topic	Status: Present Edition	Q/P in Prior Edition
1	Precedents of Courts	New	
2	Treaties	Unchanged	2
3	Joint Conference Committee	Unchanged	3
4	Regulations, revenue rulings, revenue procedures, letter rulings	Unchanged	4
5	Authority	Unchanged	5
6	Regulations	Unchanged	6
7	Citations	Modified	7
8	Small Cases Division	Unchanged	8
9	U.S. District Court	Unchanged	9
10	Judicial alternatives: trial courts	Unchanged	10
11	Judicial system	Unchanged	11
12	Tax Court and appeal process	Unchanged	12
13	Trial Courts	Unchanged	13
14	Circuit Court of Appeals	Modified	14
15	Supreme Court	Unchanged	15
16	Court decision validity	Unchanged	16
17	Tax Court Regular and Memorandum decisions	Unchanged	17
18	Citations	Unchanged	18
19	Abbreviations	Unchanged	19
20	Citations	Unchanged	20
21	Court of Federal Claims	Unchanged	21
22	Cumulative Bulletin	Unchanged	22
23	Citations	Unchanged	23
24	Tax research	Modified	24
25	Judicial system	Unchanged	25

<u>Question/ Problem</u>	<u>Topic</u>	<u>Status: Present Edition</u>	<u>Q/P in Prior Edition</u>
26	Judicial system	Unchanged	26
27	Citations	Modified	27
28	Tax sources	Unchanged	28
29	Ethics problems	Unchanged	29
30	Ethics problems	Unchanged	30
31	Internet	Unchanged	31
32	Internet activity	New	
33	Uncertainty produced by court decisions	Unchanged	32
34	Code citations	Unchanged	33
<u>Bridge Discipline Problem</u>			
1	Sources of federal tax law	Unchanged	1
<u>Research Problem</u>			
1	Locating article in tax journal	Unchanged	1
2	Citations	Unchanged	2
3	Citations	Unchanged	3
4	Citations	Unchanged	4
5	Citations	Unchanged	5
6	Locating a decision	Unchanged	6
7	Library research	Unchanged	7
8	Reliability	New	
9	Internet activity	Unchanged	8
10	Internet tax research	Unchanged	11

PROBLEMS

1.
 - 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.

p. 2-14 and Figure 2-3

2.

Smith, Raabe, and Maloney, CPAs
5191 Natorp Boulevard
Mason, OH 45040

March 22, 2008

Mrs. Barbara Brown
Mallard, Inc.
100 International Drive
Tampa, Florida 33620

Dear Mrs. Brown:

This letter is in response to your request about information concerning a conflict between a U.S. treaty with the Ukraine and a Section of the Internal Revenue Code. The major reason for treaties between the U.S. 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 Ukrainian 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

p. 2-7

3. When the Senate version of a tax bill differs from that passed by the House, the Joint Conference Committee, which includes members of both the House Ways and Means Committee and the Senate Finance Committee, is called upon to resolve these differences. The result, usually a compromise of the two versions, is then voted on by both the House and the Senate. pp. 2-3 and 2-4
4.
 - 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 CB 544. pp. 2-7 to 2-9
 - 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. p. 2-9
 - 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. p. 2-10
 - 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. pp. 2-10 and 2-11
5. The items would probably be ranked as follows (from highest to lowest):
 - (1) Internal Revenue Code.
 - (2) Legislative Regulation.
 - (3) Interpretive Regulation.
 - (4) Revenue Ruling.
 - (5) Proposed Regulation (most courts ignore Proposed Regs.).
 - (6) Letter ruling (valid only to the taxpayer to whom issued).pp. 2-7 to 2-11, 2-22 to 2-24, and Exhibit 2-1

6. Since 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.
 - a. Reg. § 1.61.
 - b. Prop. Reg. § 1.311.
 - c. Reg. § 20.2032T.pp. 2-7 and 2-8
7.
 - a. A proposed regulation, with 1 referring to the type of regulation, 280A is the related code section (when there is not enough space, subsequent code sections are given A,B,C, etc. designations), 3 is the regulation number, (c) is the regulation paragraph designation, and (4) is the regulation subparagraph designation. p. 2-8
 - b. Revenue Ruling number 72, appearing on page 1154 of volume 50 of the Cumulative Bulletin issued in 2007. pp. 2-9 and 2-10
 - c. Letter Ruling number 14 issued during the 50th week of 2007. p. 2-10
8.
 - a. No. There is no appeal from the Small Cases Division.
 - b. No. Deficiency cannot exceed \$50,000.
 - c. Yes.
 - d. No. Decisions are not published.
 - e. Yes.
 - f. Yes.p. 2-12
9. The major advantage of a 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 first must be paid before the Court will hear and decide the controversy. In the U.S. Tax Court, the tax need not be paid prior to litigating the controversy (although interest will be due on an unpaid deficiency). pp. 2-12 and 2-13

10. Smith, Raabe, and Maloney, CPAs
5191 Natorp Boulevard
Mason, OH 45040

July 14, 2008

Mr. Carl Jensen
200 Mesa Drive
Tucson, AZ 85714

Dear Mr. Jensen:

You have three alternatives should you decide to pursue your \$274,000 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 possible 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 first 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 has rendered an adverse decision. Such a taxpayer may select the Court of Federal Claims, since any appeal instead will be to the Federal Circuit. One disadvantage of the Court of Federal Claims is that the tentative deficiency first 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

pp. 2-12, 2-13, and Figure 2-3

- 11. See Figure 2-3 and the related discussion.
 - 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. p. 2-12
 - b. The first appeal would be to the Sixth Court of Appeals. Further appeal would be to the U.S. Supreme Court. pp. 2-13, 2-14, and Figure 2-4
 - c. Same as b. above. p. 2-13 and Figure 2-4
 - d. The appeal would be to the Federal Circuit and then to the U.S. Supreme Court. p. 2-13

12. There could be numerous reasons why the IRS may decide not to appeal a case that it loses in the U.S. Tax Court. The failure to appeal, therefore, does not necessarily mean that the IRS agrees with any result that was reached therein. p. 2-14

13.		U.S. Tax Court	U.S. District Court	U.S. Court of Federal Claims
		<u>19</u>	<u>1</u>	<u>16</u>
a.	Number of regular judges	No	Yes	No
b.	Jury trial	No	Yes	Yes
c.	Prepayment of deficiency required before trial	No	Yes	Yes

Concept Summary 2-1

- 14. A U.S. District Court decision from Florida (choice c.) may be appealed to the Eleventh Circuit Court of Appeals. Other states in the jurisdiction of the Eleventh Circuit Court of Appeals are Georgia and Alabama. p. 2-14 and Figure 2-4
- 15. The U.S. Supreme Court decides whether to hear any case, tax or otherwise, by requiring an affirmative vote of at least four judges. The Court accepts jurisdiction by granting a writ (i.e., *certiorari granted*) or denies jurisdiction (i.e., *certiorari denied*). The Supreme Court rarely hears tax cases. The Court may grant *certiorari*, however, to resolve a conflict among the Courts of Appeals or where the tax issue is extremely important. p. 2-14
- 16.
 - a. If the taxpayer chooses a U.S. District Court as the trial court for litigation, the U.S. District Court of Wyoming would 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. pp. 2-14 and 2-23
 - b. If the taxpayer chooses the U.S. Court of Federal Claims as the trial court for litigation, the decision that previously was rendered 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 would 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. pp. 2-14 and 2-23

- 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. Since the taxpayer lives in California, however, any appeal from a U.S. District Court or the U.S. Tax Court would 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. pp. 2-14, 2-23, and Figure 2-4
 - d. In that 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. pp. 2-14, 2-23, and 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. p. 2-16
 - 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. p. 2-16
17. 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 web site. 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 Internet web site.
- pp. 2-16 and 2-17
18. a. This is a citation for a Regular decision of the U.S. Tax Court that was issued in 1970. The decision can be found in Volume 54, page 1514, of the *Tax Court of the United States Reports*, published by the U.S. Government Printing Office. p. 2-16

- b. This is a citation for a decision of the U.S. Second Circuit Court of Appeals that was rendered in 1969. The decision can be found in Volume 408, page 117, of the *Federal Reporter, Second Series* (F.2d), published by West Publishing Company. p. 2-17
- c. This is a citation for a decision of the U.S. Second Circuit Court of Appeals that was rendered in 1969. The decision can be found in Volume 1 for 1969, paragraph 9319, of the *U.S. Tax Cases*, published by Commerce Clearing House. p. 2-17
- d. This is a citation for a decision of the U.S. Second Circuit Court of Appeals that was rendered in 1969. The decision can be found in Volume 23, page 1090, of the Second Series of *American Federal Tax Reports*, now published by RIA (formerly P-H). p. 2-17

[Note that the citations that appear in parts b., c., and d. are for the same case.]

- e. This is a citation for a decision of the U.S. District Court of Mississippi that was rendered in 1967. The decision can be found in Volume 293, page 1129, of the *Federal Supplement Series*, published by West Publishing Company. p. 2-17
- f. This is a citation for a decision of the U.S. District Court of Mississippi that was rendered in 1967. The decision can be found in Volume 1 for 1967, paragraph 9253, of the *U.S. Tax Cases*, published by Commerce Clearing House. p. 2-17
- g. This is a citation for a decision of the U.S. District Court of Mississippi that was rendered in 1967. The decision can be found in Volume 19, page 647, of the Second Series of *American Federal Tax Reports*, now published by RIA (formerly P-H). p. 2-17

[Note that the citations that appear in parts e., f., and g. are for the same case.]

- h. This is a citation for a decision of the U.S. Supreme Court that was rendered in 1935. The decision can be found in Volume 56, page 289, of the *Supreme Court Reporter*, published by West Publishing Company. p. 2-18
- i. This is a citation for a decision of the U.S. Supreme Court that was rendered in 1935. The decision can be found in Volume 1 for 1936, paragraph 9020, of the *U.S. Tax Cases*, published by Commerce Clearing House. p. 2-18
- j. This is a citation for a decision of the U.S. Supreme Court that was rendered in 1935. The decision can be found in Volume 16, page 1274, of the *American Federal Tax Reports*, now published by RIA (formerly P-H). p. 2-18

[Note that the citations that appear in parts h., i., and j. are for the same case.]

- k. This is a citation for a decision of the former U.S. Court of Claims that was rendered in 1970. The decision can be found in Volume 422, page 1336, of the *Federal Reporter, Second Series*, published by West Publishing Company. This court is the Claims Court (renamed the Court of Federal Claims effective October 30, 1992) and current cases are in the *Federal Claims Reporter*. p. 2-17
19. a. CA-2. An abbreviation that designates the U.S. Second Circuit Court of Appeals. p. 2-17

- 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. p. 2-17
 - c. *aff'd*. An abbreviation for “affirmed,” which indicates that a lower court decision was affirmed (approved of) on appeal. p. 2-15
 - d. *rev'd*. An abbreviation for “reversed”, which indicates that a lower court decision was reversed (disapproved of) on appeal. p. 2-15
 - e. *rem'd*. An abbreviation “remanded”, which indicates that a lower court decision is being sent back by a higher court for further consideration. p. 2-15
 - f. *Cert. denied*. The *Writ of Certiorari* has been denied by the U.S. Supreme Court. This means that the Court will not accept an appeal from a lower court and, therefore, will not consider the case further. p. 2-14
 - g. *Acq.* An abbreviation for “acquiescence” (agreement). The IRS follows a policy of either acquiescing or nonacquiescing to certain court decisions. p. 2-16
 - 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. p. 2-16
 - i. USTC. U.S. District Court, U.S. 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. p. 2-17
 - j. AFTR. See the solution to i. above. p. 2-17
 - k. F.3d. All of the decisions (both tax and nontax) of the U.S. Claims Court (before October 1982) and the U.S. 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). p. 2-17
 - 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.). p. 2-17
 - m. USSC. An abbreviation for the U.S. Supreme Court. p. 2-18
 - n. S.Ct. West Publishing Company publishes all of the U.S. Supreme Court decisions in its *Supreme Court Reporter* (S.Ct.). p. 2-18
 - o. D.Ct. An abbreviation for a U.S. District Court decision. p. 2-17
- 20.
- a. U.S. Tax Court (formerly the Board of Tax Appeals).
 - b. U.S. Supreme Court.
 - c. Memorandum decision of the U.S. Tax Court.
 - d. U.S. Third Circuit Court of Appeals.
- pp. 2-16 to 2-18

21. Decisions of the U.S. Court of Federal Claims (formerly named the Claims Court) are published in the USTCs, AFTRs, and the West Publishing Company 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. p. 2-17
22. a. Yes. Exhibit 2-1
b. No. Not published. p. 2-12
c. No. Published by private publishers. Exhibit 2-1 and p. 2-10
d. Yes. Exhibit 2-1 and p. 2-10
e. Yes. Exhibit 2-1 and p. 2-9
f. No. p. 2-17
g. Yes, when major tax legislation has been enacted by Congress. p. 2-10 and Footnote 12
h. Yes. p. 2-16
i. No. p. 2-17
23. a. The U.S. Tax Court. p. 2-16
b. Yes, the appellate court affirmed, or agreed with, the trial court. p. 2-15
c. United Draperies, Inc., the taxpayer. p. 2-16
d. Yes, in effect, by issuing cert. denied to the appellate court decision (refusing to hear the decision). p. 2-14
24. After understanding the relevant facts:
- Ashley 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.
 - Ashley 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.
 - Ashley 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.
 - Ashley 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 World Wide Web feature of the Internet. Various legal, accounting, and financial gateways can be found by clicking on highlighted words or phrases.

pp. 2-20 to 2-30

- 25.
- a. James 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. Concept Summary 2-1
 - b. James 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. pp. 2-12, 2-13, and Figure 2-3
 - 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. pp. 2-16 and 2-23
 - d. The U.S. Court of Federal Claims is a trial court that usually meets in Washington, D.C., and James 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 Fifth Court of Appeals (and not to the Eleventh). Figures 2-3 and 2-4
 - e. Few tax decisions reach the U.S. Supreme Court. The U.S. Supreme Court must agree to hear a court case. p. 2-14
- 26.
- a. T. Concept Summary 2-1
 - b. C (before October 1982) and A. p. 2-17
 - c. D, C, A, and U. pp. 2-17 and 2-18
 - d. D, C, A, and U. pp. 2-17 and 2-18
 - e. U. p. 2-14
 - f. C and U. pp. 2-12, 2-13, and 2-17
 - g. D. Concept Summary 2-1
 - h. D, T, and C. p. 2-11 and Figure 2-3
 - i. A and U. p. 2-13 and Figure 2-3
 - j. C. Concept Summary 2-1 and Figure 2-3
 - k. T. p. 2-12 and Figure 2-3
 - l. T. p. 2-13 and Concept Summary 2-1
- 27.
- a. N, a cite for an IRS Revenue Procedure.
 - 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.
 - f. D, U.S. District Court.
 - g. T, U.S. Tax Court.
 - h. N, a cite for an Announcement.
 - i. T, U.S. Tax Court's Small Cases Division decision.
- pp. 2-10, 2-11, 2-16 to 2-18, and Concept Summary 2-2
28.
 - a. P.
 - b. P.
 - c. P.
 - d. S.
 - e. P.
 - f. S.
 - g. P. Valid for 3 years.
 - h. P.
 - i. N.
 - j. P.

pp. 2-22 to 2-24
29. 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 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. pp. 2-18 and 2-19

30. 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. Chapter 1
31. All tax problems cannot be solved merely with the Internet. There are still many holes in the World Wide Web, although conclusions about some tax problems may be determined through conducting Internet searches. pp. 2-27 and 2-28
32. The Internet Activity research problems require that the student 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 web sites 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.

Build interaction into the exercise wherever possible, asking the student to send and receive e-mail in a professional and responsible manner.

33. In some situations, judicial decisions led to changes in the Code in order to add clarity to the result reached and to provide "safe harbors" for planning purposes. An example includes:

- The enactment of §§ 302(b)(2) and (3) [the "substantially disproportionate" and "complete termination of an interest" types of stock redemptions] provided more definite criteria as to when a stock redemption will be treated as an exchange or as a dividend. Previous to this time, the only test was the judicially formulated "not essentially equivalent to a dividend" which was none too clear and treacherous to rely on.

In other situations, judicial decisions led to changes in the Code in order to neutralize the effect of such decisions. In other words, Congress disagreed with the result reached and, so to speak, chose to undo the damage done. An example includes:

- The passage of the general rule of § 357(a), to prevent the transfer of a liability to a controlled corporation under § 351 from being treated as boot or "other property" (see Chapter 9). This rule negated the result reached by the U.S. Supreme Court in the *Hendler* decision, 38-1 USTC ¶ 9215, 20 AFTR 1041, 58 S.Ct. 655 (USSC, 1938).

34. 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 PROBLEM

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.

- 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.

RESEARCH PROBLEMS

1. “Below-Market Loans May Have Unexpected Tax Results” is the title of the article, which appears on pages 350–357. On page 351, a below-market loan fits into two categories: demand loan or term loan.
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.
- 4.
- a. Defines derivative to include an evidence of an interest or derivative contract in any note, bond, debenture, or other evidence of indebtedness.
 - b. Describes how an educational institution may obtain automatic consent to change its reporting method under Section 6050S.
 - c. Since land is a capital asset, any settlement proceeds represent amounts for injury or damage to a capital asset. Thus, the proceeds should be treated as a recovery of a taxpayer's basis in the land and any excess is a capital gain.
 - d. Earned income generally includes taxable wages, salaries, tips, and other employee compensation and net earnings from self-employment.
 - e. Denied head of household status to a taxpayer who lived with her children in her former in-laws' residence and brother's home even though she paid monthly rent, etc.
- 5.
- a. *Stubbs, Overbeck & Associates, Inc.*, 445 F.2d 1142 (CA-5, 1971).
 - b. *Mead Corp.*, 533 U.S. 218 (2001).
 - c. *Trinova Corp.*, 108 T.C. 68 (1997).
 - d. Notice 2003-18, 2003-1 C.B. 699.
 - e. *Linda Craven*, 215 F.3d 1201 (CA-11, 2000).
 - f. *Anglo-Am. Direct Tea Trading Co.*, 38 B.T.A. 711 (1938).
 - g. *Nancy J. Vincent*, T.C. Memo. 2005-95.
 - h. Rev.Rul. 75-28, 1975-1 C.B. 68.
6. 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.

7. Section 152(f)(3) allows the IRS to disallow a dependency deduction where a relationship is in violation of local law:

“An individual is not a member of the taxpayer’s household if at any time during the taxable year of the taxpayer the relationship between such individual and the taxpayer is in violation of local law.” S. Rep. No. 1983, 85th Cong., 2d Sess. Indicates that it was the intention of Congress to preclude any dependency deduction for the partner of a taxpayer when the two are living in a quasim marital relationship, which is illicit under the laws of the state in which they reside.

John T. Untermann, 38 T.C. 93 (1962) holds that marital allowances are available only if the man and woman taxpayers are legally married under the laws of the state in which they reside. In a more recent decision [*Cassius L. Peacock, III*, 37 TCM 177, T.C. Memo. 1978-30] involving the interpretation of Arizona law, the exemption was denied on the same grounds.

The couple might consider moving to another state to salvage the deduction in future years. If a state has no criminal sanctions for sexual activity between consenting adults (e.g., California), the dependency exemption would be allowable. See, for example, *In Re Shackelford v. U.S.* [80-1 USTC ¶ 9276, 45 AFTR2d 80-1074 (D.Ct. Mo., 1980)] where the court interpreted Missouri law so as to permit an unmarried female to claim a dependency exemption for a male who was living with her and had no source of income. See Chapter 3 for a general discussion of personal and dependency exemptions.

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

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

9. The Internet Activity research problems require that the student 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 web sites 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.

Build interaction into the exercise wherever possible, asking the student to send and receive e-mail in a professional and responsible manner.

10. See the Internet Activity comment above.

NOTES