Chapter C:1

Tax Research

Note: To do the online research problems for this chapter, textbook users must have access to the described Internet-based tax services at their institution.

Discussion Questions

C:1-1 In a closed-fact situation, the facts have occurred, and the tax advisor's task is to analyze them to determine the appropriate tax treatment. In an open-fact situation, by contrast, the facts have not yet occurred, and the tax advisor's task is to plan for them or shape them so as to produce a favorable tax result. p. C:1-2.

C:1-2 According to the AICPA's Statements on Standards for Tax Services, the tax practitioner owes the client the following duties: (1) to inform the client of (a) the potential adverse consequences of a tax return position, (b) how the client can avoid a penalty through disclosure, (c) errors in a previously filed tax return, and (d) corrective measures to be taken; (2) to inquire of the client (a) when the client must satisfy conditions to take a deduction and (b) when information provided by him or her appears incorrect, incomplete, or inconsistent on its face; and (3) not to disclose tax-related errors without the client's consent. pp. C:1-32 through C:1-35.

C:1-3 When tax advisors speak about "tax law," they refer to the IRC as elaborated by Treasury Regulations and administrative pronouncements and as interpreted by federal courts. The term also includes the meaning conveyed by committee reports. p. C:1-7.

C:1-4 Committee reports concerning tax legislation explain the purpose behind Congress' proposing the legislation. Transcripts of hearings reproduce the testimonies of the persons who spoke for or against the proposed legislation before the Congressional committees. Committee reports are sometimes used to interpret the statute. p. C:1-7.

C:1-5 Committee reports can help resolve ambiguities in statutory language by revealing Congressional intent. They are indicative of this intent. pp. C:1-7 and C:1-8.

C:1-6 The Internal Revenue Code of 1986 is updated for every statutory change to Title 26 subsequent to 1986. Therefore, it includes the post-1986 tax law changes enacted by Congress and today reflects the current state of the law. p. C:1-8.

C:1-7 No. Title 26 deals with all taxation matters, not just income taxation. It covers estate tax, gift tax, employment tax, alcohol and tobacco tax, and excise tax matters. p. C:1-8.

C:1-8 a. Subsection (c). It discusses the tax treatment of property distributions in general (e.g., amount taxable, amount applied against basis, and amount exceeding basis).

b. Because Sec. 301 applies to the entire chapter, one should look throughout that entire chapter (Chapter 1 of the IRC – which covers Sec. 1 through Sec. 1400U-3) for any exceptions. One special rule – Sec. 301(e) – is found in Sec. 301. This special rule explains the tax treatment of dividends received by a 20% corporate taxpayer. Section 301(f) indicates some of the important special rules found in other IRC sections.

c. Legislative. Section 301(e)(4) authorizes the issuance of Treasury Regulations as may be necessary to carry out the purposes of the subsection. pp. C:1-9 through C:1-10.

C:1-9 Researchers should note the date on which a Treasury Regulation was adopted because the IRC may have been revised subsequent to that date. That is, the regulation may not interpret the current version of the IRC. Discrepancies between the IRC and the regulation occur when the Treasury Department has not updated the regulation to reflect the statute as amended. p. C:1-9.

C:1-10 a. Proposed regulations are not authoritative, but they do provide guidance concerning how the Treasury Department interprets the IRC. Temporary regulations, which are binding on the taxpayer, often are issued after recent revisions to the IRC so that taxpayers and tax advisers will have guidance concerning procedural and/or computational matters. Final regulations, which are issued after the public has had time to comment on proposed regulations, are considered to be somewhat more authoritative than temporary regulations. pp. C:1-9 and C:1-10.

b. Interpretative regulations make the IRC's statutory language easier to understand and apply. They also often provide computational illustrations. In the case of legislative regulations, Congress has delegated the rulemaking on a specific topic (either narrow or broad) to the Treasury Department. However, after the Mayo Foundation case, both types of regulations will have the same authoritative weight. p. C:1-10.

C:1-11 Legislative. In the past, it was more difficult for a taxpayer to successfully challenge this type of regulation because Congress has delegated its rulemaking authority to the Treasury Department. However, after the Mayo Foundation case, both types of regulations will have the same authoritative weight. p. C:1-10.

C:1-12 Under the legislative reenactment doctrine, a Treasury Regulation is deemed to have been endorsed by Congress if the regulation was finalized before a related IRC provision was enacted and in the interim, Congress did not amend the statutory provision to which the regulation relates.
p. C:1-10.

C:1-13 a. Revenue rulings are not as authoritative as court opinions, Treasury Regulations, or the IRC. They represent interpretations by an interested party, the IRS. p. C:1-12.

b. If the IRS audits the taxpayer's return, the IRS likely will contend that the taxpayer should have followed the ruling and, therefore, owes a deficiency. p. C:1-12.

C:1-14 a. The Tax Court, the U.S. Court of Federal Claims, or the U.S. district court for the taxpayer's jurisdiction. p. C:1-14.

b. The taxpayer might consider the precedent, if any, existing within each jurisdiction. The taxpayer might prefer to avoid expending cash to pay the proposed deficiency. If so, the taxpayer would want to litigate in the Tax Court. If the taxpayer would like to have a jury trial address questions of fact, he or she should opt for the U.S. district court. pp. C:1-14 through C:1-19, p. C:1-21, and p. C:1-23.

c. Appeals from Tax Court and U.S. district court decisions are made to the circuit court of appeals for the taxpayer's geographical jurisdiction. U.S. Court of Federal Claims decisions are appealable to the Court of Appeals for the Federal Circuit. Appeals from any of the circuit courts of appeals may be brought to the U. S. Supreme Court. pp. C:1-20 through C:1-21.

C:1-15 No. A taxpayer may not appeal a case litigated under the Tax Court's Small Cases Procedure. p. C:1-17.

C:1-16 Tax Court regular and memo decisions have about the same precedential value. Decisions issued under the Small Cases Procedure of the Tax Court have little or no precedential value.
pp. C:1-15 and C:1-17.

C:1-17 Yes. The IRS can acquiesce (or nonacquiesce) in any federal court decision that is adverse to the IRS if the IRS decides to do so. In many cases the IRS does not acquiesce or nonacquiesce. p. C:1-17.

C:1-18 In both the AFTR and USTC: decisions of U.S. district courts, U.S. bankruptcy courts, U.S. Court of Federal Claims, circuit courts of appeal, and the U.S. Supreme Court. Tax Court decisions are reported in neither of the two reporters. pp. C:1-16 and C:1-17 through C:1-22.

C:1-19 When first issued, revenue rulings appear in the weekly Internal Revenue Bulletin (I.R.B.). Twice each year, the decisions published in the I.R.B. are bound together and published in the Cumulative Bulletin (C.B.). The I.R.B. citation is appropriate only until the ruling is published in the C.B. p. C:1-12.

C:1-20 According to the Golsen Rule, the Tax Court will not follow a decision it made earlier, but rather will follow a decision of the circuit court of appeals to which the case under consideration is appealable. As an example, assume that the Tax Court, in a case involving a First Circuit taxpayer, ruled for the taxpayer. The issue had not been litigated earlier. Then, a U.S. district court in Georgia decided a case involving the same issue in favor of another taxpayer. The Eleventh Circuit, however, reversed the decision. Now a taxpayer from the Eleventh Circuit litigates the same issue in the Tax Court. Under the Golsen Rule, the Tax Court will follow the Eleventh Circuit's decision favoring the government. The Tax Court need not follow an appeals court decision if a case was litigated by a taxpayer whose appeal would have been made to any circuit other than the Eleventh. p. C:1-21.

C:1-21 a. The precedent binding upon a California taxpayer would be the Tax Court case. The Tax Court has national jurisdiction. pp. C:1-21 and C:1-23.

b. Under the Golsen Rule, the Tax Court will depart from its earlier decision and follow the Fifth Circuit's decision favoring the government. p. C:1-21.

C:1-22 a. Congressional Record
b. Internal Revenue Bulletin
c. Tax Court of the United States Reports
d. Federal Register, Internal Revenue Bulletin, and/or Cumulative Bulletin

e. Federal Supplement, American Federal Tax Reports (only tax-related), United States Tax Cases (only tax-related).

f. Not found in an "official" publication; published by tax services

pp. C:1-7, C:1-12 through C:1-14, and C:1-17 through C:1-19.

C:1-23 A tax advisor might find the provisions of a tax treaty useful where a U.S. taxpayer engages in transactions in a foreign country. The United States has tax treaties with over 55 countries. p. C:1-24.

C:1-24 Citators (1) trace the history of the case in question and (2) list other authorities that have cited such case. p. C:1-30.

C:1-25 First, CHECKPOINT lists all citing cases and not just those that the editors believe will serve as precedent. Second, CHECKPOINT indicates how the case in question was cited (favorably, unfavorably, distinguished, etc.). p. C:1-30.

C:1-26 Keyword, index, citation, or content are the four ways to search in CHECKPOINT and INTELLICONNECT databases. p. C:1-27.

C:1-27 a. The principal primary sources found in both INTELLICONNECT and CHECKPOINT are as follows:

- IRC
- Treasury Regulations
- Court opinions
- Revenue rulings and procedures
- Letter rulings
- Committee reports
- Tax treaties

b. The principal secondary sources found in INTELLICONNECT are as follows:

- Standard Federal Income Tax Reporter
- Federal Estate and Gift Tax Reporter
- Federal Excise Tax Reporter
- Tax Treaties Reporter
- Master Tax Guide

The principal secondary sources found in CHECKPOINT are as follows:

- Federal Tax Coordinator
- United States Tax Reporter
- RIA Federal Tax Handbook
- Warren, Gorham & Lamont journals and treatises

pp. C:1-26 through C:1-29.

C:1-28 The features (i.e., icons, templates, and command buttons) will vary depending upon the particular tax service/Internet site accessed. Just about all commercial tax databases can be searched by keyword and citation. Some can be searched by table of contents and topic. Most

noncommercial tax databases can be searched by keyword. Some can be searched by citation and table of contents.

The advantages of using a commercial tax service (as opposed to a noncommercial service) are broader database scope, greater historical coverage, and more efficient search engines. The principal disadvantage is cost.

Because of their relative disadvantages, the noncommercial sites should not be regarded as a substitute for a commercial tax service. Access is non-uniform. The scope and breadth of their databases are limited. pp. C:1-26 through C:1-28.

C:1-29 The CPA should have a good faith belief that his or her position has a realistic possibility of being sustained administratively or judicially on its merits if challenged. p. C:1-33.

C:1-30 Under the AICPA's Statements on Standards for Tax Services (SSTSs), a tax preparer is not obligated (1) to verify client provided information if the information is not suspicious on its face and (2) to update professional advice based on developments following its original conveyance. pp. C:1-33 and C:1-34.

C:1-31 The two primary classifications of written advice under Circular 230 are (1) covered opinions and (2) other written advice. A covered opinion refers to tax advice rendered on a tax shelter type transaction the IRS has identified (listed) as having a tax avoidance purpose. The Treasury Department proposed changes to these rules in 2012. C:1-32.

C:1-32 Circular 230 is a government issued document that dictates rules for practicing before the IRS. The Statements on Standards for Tax Services (SSTSs) are ethical standards issued by the AICPA aimed at tax practitioners. Circular 230 applies only to federal tax issues, and the SSTSs apply to both federal and state issues. Circular 230 only applies to income taxes, and the SSTSs apply to all types of taxes. Finally, Circular 230 does not provide the same depth of ethical guidance found in the SSTSs. p. C:1-32.

Problems

C:1-33 a. Yes. According to Secs. 71(a) and (b), the wife includes $25,000 per year. Also, the divorce agreement must explicitly state that the husband has no liability to make payments after the wife's death. See Sec. 71(b)(1)(D) and Temp. Reg. Sec. 1.71-1T(b), Q-11.

b. Yes. The husband deducts $25,000 per year according to Secs. 215(a) and (b). According to Sec. 62(a)(10), the alimony is deductible for AGI. pp. C:1-8 and C:1-26 through
C:1-29.

C:1-34 a. Legislative. According to Sec. 385(a), "The Secretary is authorized to prescribe such regulations as may be necessary or appropriate. . . ."

b. Yes. Section 385(a) states that the regulations will be applicable "for purposes of this title." "This title" is Title 26 of the federal statutes. Because Title 26 encompasses all tax statutes, the regulations would be relevant for estate tax purposes. pp. C:1-8 through C:1-10 and C:1-26 through C:1-29.

C:1-35 a. Both rulings hold that contributions to a fund formed to acquire a portrait of a former judge and donated to a governmental agency are deductible under Sec. 170. p. C:1-29.

b. Private letter rulings cannot be cited as precedence and apply only to the taxpayer for whom the IRS issued the ruling. pp. C:1-12 and C:1-13.

c. Revenue rulings can be cited as precedence, and they are relied on by both taxpayers and the IRS for guidance in particular factual situations. pp. C:1-12 and C:1-13.

C:1-36 Sections 355 and 856. The official IRS publication is the Internal Revenue Bulletin, which eventually is incorporated into the Cumulative Bulletin. pp. C:1-12 and C:1-29.

C:1-37 Results might vary as the service adds or deleted documents, but as of this writing:

a. 54.

b. 26.

c. 15.

d. The program default presents results sorted by IRC section, and in this case those results listed first are not on point. However, when sorted by relevance, the very first result addresses expenses related to a home office deduction. The effect is similar to using Boolean connectors. pp. C:1-26 through C:1-28.

C:1-38 Results might vary as the service adds or deleted documents, but as of this writing:

a. 52.

b. 1.

c. In Part a, the search engine uses the thesaurus to include in the search other terms for *home*. Because most tax documents do not use the term *home*, limiting the search results to only those documents including "home sale" is not ideal. The researcher will not see the majority of documents relevant to the search question. The one result is fortunate, and provides a general answer, but if the student needs clarification, those documents are not presented.

d. Principle residence. pp. C:1-26 through C:1-28.

C:1-39 a. Acquiescence. See AOD 1986-030, 1986-1 C.B. 1.

b. No. The acquiescence was only with respect to whether a transfer to the taxpayer's spouse is a taxable disposition. pp. C:1-17 and C:1-29.

C:1-40 a. Acquiescence. See 1953-1 C.B. 6.

b. Partial. It dealt with sales taxes.

c. Yes. In 1981, he withdrew the acquiescence on the issue of sales tax deduction and nonacquiesced (see AOD 1981-184, 1981-2 C.B. 3). pp. C:1-17 and C:1-29.

C:1-41 a. Nonacquiescence. See AOD 1988-014, 1988-2 C.B.1.

b. Yes. In 2003, the Commissioner withdrew the 1988 AOD and acquiesced. See AOD 2003-001, 2003-2 I.R.B.

C:1-42 a. Yes. The case was reviewed by the court. No. It was not a unanimous decision. Judges Korner, Swift, and Gerber did not participate. Judge Simpson dissented. pp. C:1-26 through C:1-29.

b. Yes. The decision was entered under Rule 155. p. C:1-17.

c. Yes. The case was reviewed by the Sixth Circuit Court of Appeals. pp. C:1-30 and C:1-31.

C:1-43 a. Yes. The case was reviewed by the court. The decision was not unanimous. Judge Quealy dissented. Judge Tannenwald issued a concurring opinion with which five judges agreed. Judge Chabot issued a dissenting opinion with which three judges agreed, and Judge Nims issued a dissenting opinion with which three judges agreed. pp. C:1-26 through C:1-29.

b. No. The decision was not entered under Rule 155. p. C:1-17.

c. Yes. The case was reviewed by the Sixth Circuit Court of Appeals in 1982. pp. C:1-30 and C:1-31.

C:1-44 a. National Cash Register Co. v. U.S., 400 F.2d 820, 22 AFTR 2d 5562, 68-2 USTC ¶9576 (6th Cir., 1968).

b. Thomas M. Dragoun, 1984 RIA T.C. Memo ¶84,094 (T.C. Memo 1984-94), 47 TCM 1176.

c. U.S. v. John M. Grabinski, 558 F. Supp. 1324, 52 AFTR 2d 83-5169, 83-2 USTC ¶9460 (DC MN, 1983).

d. U.S. v. John M. Grabinski, 727 F.2d 681, 53 AFTR 2d 84-710, 84-1 USTC ¶9201 (8th Cir., 1984).

e. Rebekah Harkness v. U.S., 469 F.2d 310, 30 AFTR 2d 72-5754, 72-2 USTC ¶9740 (Ct. Cl., 1972). Note that during this period, Court of Claims decisions were published in the Federal Reporter, Second Series. Alternatively, you could give the citation 199 Ct. Cls. 721, which references the Court of Claims Reporter. In the RIA citator the name of the case is simply Harkness.

f. Hillsboro National Bank v. CIR, 460 U.S. 370, 51 AFTR 2d 83-874, 83-1 USTC ¶9229 (USSC, 1983).

g. Rev. Rul. 78-129, 1978-1 C.B. 67. pp. C:1-17 through C:1-22.

C:1-45 a. Rev. Rul. 99-7, 1999-1 C.B. 361.

b. Frank H. Sullivan, 1 B.T.A. 93 (1924).

c. Tate & Lyle, Inc., 103 T.C. 656 (1994).

d. Ralph L. Rogers v. U.S., 539 F. Supp. 104, 49 AFTR 2d 82-1160, 82-1 USTC ¶9246 (DC OH, 1982).

e. Norman Rodman v. CIR, 542 F.2d 845, 38 AFTR 2d 76-5840, 76-2 USTC ¶9710 (2nd Cir., 1976). pp. C:1-17 through C:1-22.

C:1-46 a. Circuit Court of Appeals for the Ninth Circuit; page 1198 of Volume 648 of the Federal Reporter, Second Series and page 81-5353 of Volume 48 of the American Federal Tax Reports, Second Series.

b. U. S. Court of Federal Claims; page 455 of Volume 14 of the Claims Court Reporter and paragraph (not page) 9231 of Volume 1 of the 1988 U. S. Tax Cases.

c. Supreme Court; page 13 of Volume 309 of the United States Supreme Court Reports and page 816 of Volume 23 of the American Federal Tax Reports.

d. A U.S. District Court in Texas; page 76 of Volume 441 of the Federal Supplement and page 78-335 of Volume 41 of the American Federal Tax Reports, Second Series.

e. Not a court decision; page 72 of Volume 1 of the 1983 Cumulative Bulletin.

f. Circuit Court of Appeals for Sixth Circuit; page 474 of Volume 568 of the Federal Reporter, Second Series and paragraph (not page) 9199 of Volume 1 of the 1978 U.S. Tax Cases. pp. C:1-16 and C:1-22.

C:1-47 a. "Medical expenses, cosmetic surgery" is discussed at ¶2134.04 and 2135.05(42) and cosmetic surgery costs is discussed at ¶2134.04.

b. Section 213(d)(9) is referred to in ¶2135.04. Rev. Rul 76-332, 1976-2 C.B. 81 and Rev. Rul. 2003-57, 2003-1 C.B. 959 are discussed at ¶2135.05(42).

c. Generally no. Section 213(d)(9) (effective for tax years beginning after 1990) provides that the cost of cosmetic surgery is not deductible except in certain narrow circumstances. pp. C:1-28 and C:1-29.

C:1-48 No. The regulation does not reflect the amendments to Sec. 302 made in 1996, 1997, and 1998. A caution to this effect appears at the beginning of the regulation of both services, although INTELLICONNECT does not refer to the 1998 amendments. pp. C:1-26 through C:1-29.

C:1-49 a. "Casualty losses for invasion by" is discussed at ¶10,005.029 and at ¶¶10,005.671 - 10,005.68.

b. Authorities include: Rev. Rul. 63-232, 1963-2 C.B. 97; Henry L. Sutherland, 1966 PH T.C. Memo ¶66,155, 25 TCM 822; and Martin A. Rosenberg v. CIR, 42 AFTR 2d 303, 52-2 USTC ¶9377 (8th Cir., 1952). The first two authorities denied a deduction and the third allowed a deduction. pp. C:1-28 and C:1-29.

C:1-50 a. More than 35% of the excess of the value of the decedent's gross estate over the sum of allowable Sec. 2053 and 2054 deductions. (CCH ¶15,350.)

b. No. The regulation indicates the test is more than (1) 35% of the gross estate or (2) 50% of the taxable estate. It does not reflect the P.L. 94-455 or P.L. 97-34 amendments to the IRC. A caution to this effect appears before the beginning of the reprint of the regulations. pp. C:1-26 through C:1-29.

C:1-51 a. 645.

b. 572-3rd - Accounting Methods – Adoptions and Changes.
570- 2nd - Accounting Methods – General Principles.

c. 568-4th.

d. 367.

e. 523-2nd.

p. C:1-25.

C:1-52 "Clergy, work clothes, deductibility" is discussed at ¶L-3806. The authority dealing with this topic is J.W. Ratcliff, 1983 PH T.C. Memo ¶83,636. This heading is listed in the topical index under "clergy." pp. C:1-28 through C1-29.

C:1-53 a. 7 (4 in 1954-1977 volume; 1 in 1978-1989 volume; 2 in 1990-1996 volume; 0 in the 1997-2002 cumulative supplement; and 0 in the 2003-2007 cumulative supplements). All seven citations have been integrated into one listing on CHECKPOINT.

b. 12 issues, but 13 issues are listed in the findings of fact.

c. Yes. The Fourth Circuit reviewed the case.

d. None.

e. INTELLICONNECT does not list headnote numbers. (INTELLICONNECT indicates 11 cases, and two rulings cite Biltmore.) pp. C:1-30 and C:1-31.

C:1-54 a. 23.

b. No. According to the headnote to the opinion, the decision dealt with one issue, deductions.

c. No. The decision has not been cited unfavorably although the point made in Headnote No. 1 has been distinguished in a number of cases and limited in one case.

d. 13.

e. Indeterminable. There is one cite to the Tax Court decision, but the INTELLICONNECT citator does not indicate headnote numbers. pp. C:1-30 through C:1-31.

C:1-55 a. 1972.

b. The deductibility of the cost of a customer list under Sec. 162.

c. The government. The cost was not currently deductible.

d. No. The decision was not reviewed at the trial level.

e. Yes. The decision was appealed to the Sixth Circuit Court of Appeals.

f. Yes. The RIA citator and the CCH citator list eight citations to the decision. pp. C:1-26 through C:1-31.

C:1-56 a. To file a tax return electronically, one must (1) purchase the requisite software from a commercial vendor or download it from a designated Internet site; (2) obtain a Personal Identification Number (PIN) from the IRS; (3) either prepare a tax return offline and upload, or prepare the return online; and (4) transmit the return to the IRS.

b. The taxpayer can transmit funds electronically in one of three ways: (1) by authorizing an electronic funds withdrawal from a checking or savings account; (2) by authorizing payment by credit card; or (3) by mailing to the IRS a check or money order using a payment voucher.

c. Electronic filing (1) allows the taxpayer to file a return from any personal computer; (2) is more accurate than manual filing; (3) offers the safety and security of direct deposit; (4) offers the convenience of filing a tax return early and delaying payment up to the due date, and (5) allows one to file federal and state tax returns simultaneously. pp. C:1-29 and C:1-30.

C:1-57 a. "Request for Copy of Tax Return."

b. "Corporation Claim for Deduction for Consent Dividends."

c. "Excise Tax on Greenmail."

pp. C:1-29 and C:1-30.

C:1-58 a. "Request for Copy of Tax Return."

b. "Credit for Tax Paid to Other States."

c. "New York Consolidated Franchise Tax Return."

pp. C:1-29 and C:1-30.

C:1-59 The latest data as of this writing was for January 2013.

a. 7 (Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming).

b. 2 (New Hampshire and Tennessee).

c. 9.9%.

d. Pennsylvania, 3.07%.

pp. C:1-29 and C:1-30.

Comprehensive Problem

C:1-60 STEP ONE: In searching INTELLICONNECT's Standard Federal Tax Reporter (SFTR), you would consult the topical index under "Yachts" or "Advertising, expenses for." In searching CHECKPOINT's United States Tax Reporter (USTR), you would consult the topical index under "Advertising – special or unusual forms of." In searching SFTR on INTELLICONNECT or USTR on CHECKPOINT, you would use the keyword "Yacht." Either way, in SFTR you would likely find an annotation at ¶8851.1327; in USTR you would likely find an annotation at ¶1625.356(13).

STEP TWO: In print research, you would leave the tax service reporter volume to look up the case on page 879, Volume 36 of Tax Court of the United States Reports. In computerized research, you would remain in the service and click on the hyperlinked citation. Either way, you would find the text of R.L. Henry, 36 T.C. 879. This case involved an attorney/accountant who tried to deduct the costs of insuring and maintaining a yacht on which he flew a pennant with the numerals "1040." It is analogous to your client's case.

STEP THREE: In print research, to check the status of the case, you would leave Tax Court of the United States Reports to consult a citator. In computerized research, you would remain in the service and click on the citator command button. Either way, you would discover a listing of cases that cite R.L. Henry. You also would discover that the case is still "good law."

STEP FOUR: In both print and computerized research, based on the ruling in R.L. Henry, you likely would conclude that the costs of maintaining and insuring the physician's yacht are not deductible as ordinary and necessary business expenses. pp. C:1-26 through C:1-29.

Tax Strategy Problem

C:1-61 Choose Alternative 2; file the lawsuit in the Tax Court. HPU is likely to lose a lawsuit filed in the U. S. district court (Alternative 1) because that court is bound by *district court* precedent adverse to the taxpayer. Likewise, HPU is likely to lose a lawsuit filed in the Court of Federal Claims (Alternative 3) because that court is bound by *circuit court* precedent adverse to the taxpayer. On the other hand, in the Tax Court (Alternative 2) the tax return position taken by HPU has a realistic possibility of being sustained on its merits. In a case involving HPU, the Tax Court would not be bound by the other circuit court's precedent, which is adverse to the taxpayer because of the Golsen Rule. Rather, the Tax Court would be bound by HPU's own circuit court precedent, which, based on the specific facts of the problem, is nonexistent because HPU's circuit court has merely offered *dictum*, which is not binding. However, if the Tax Court issues a ruling consistent with the circuit court's second proposition, namely, that by opening the home improvement center, HPU is merely "improving customer access to its existing products," HPU will win the lawsuit, and its deduction will be sustained. pp. C:1-21 and C:1-23.

Case Study Problem

C:1-62 Statements on Standards for Tax Services (SSTS) No. 3 states that a CPA "may in good faith rely, without verification, on information furnished by the taxpayer or by third parties" (Para. 2, reproduced in Appendix E of the text). Thus, you may accept Mal's information at face value. His increase in AGI of over $30,000 may explain his increase in charitable contributions of approximately $10,000. In the second scenario the provision from SSTS No. 3 that a CPA "should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member" would be pertinent. Recently, the IRS audited Mal's return, and Mal lacked substantiation for about 75 percent of the charitable contributions he had claimed. (He may have made the contributions, but he could not prove that he did.) Further, the round amount ($25,000) reported by Mal suggests that Mal may be estimating what he contributed. You probably should request to see substantiation (canceled checks, etc.) for the contribution(s) claimed. For charitable contributions of $250 or greater made after December 31, 1993, no deduction is allowed unless the donee organization substantiates the contribution with a contemporaneous, written acknowledgement. Mal needs to be made aware of this rule for his current year's return. All cash contributions, regardless of amount, must be documented with a bank record or written communication from the charity. The communication must include the name of the charity, date, and amount. p. C:1-33.

Tax Research Problems

C:1-63 a. The primary issue is whether the amounts Thomas A. Curtis, M.D. Inc. paid to Ellen Curtis as compensation during fiscal years 1988 and 1989 were reasonable.

b. Neither party was totally victorious. In fiscal year 1988, Ellen Curtis was paid $410,500. The amount held to be reasonable compensation by the Tax Court for 1988 was $227,000. In fiscal year 1989, Ellen Curtis was paid $510,500. The amount held to be reasonable compensation by the Tax Court for 1989 was $239,000. The amount held to be compensation, however, is more than the $100,000 and $105,000 the IRS asserted was reasonable compensation.

c. The plaintiff is the corporation because it is the party that claimed a deduction for the compensation. The IRS is attempting to disallow the corporation's deduction for part of the compensation paid. The disallowance of the deduction will have little effect on the two individuals since the amounts received will be either salary or dividends depending on the outcome of the case.

d. Ellen Barnert married Dr. Thomas Curtis in 1984.

e. Ms. Curtis worked approximately 60 to 70 hours supervising all departments set up within the corporation and the independent contractors, including scheduling and staffing of all the corporation's offices. Ms. Curtis was a registered nurse. She had a bachelor's degree in science and took worker's compensation courses at the University of Southern California Law School. She had worked as a nurse for a number of years and managed an ambulatory hospital system.

f. In fiscal year 1989, Ellen Curtis was paid $510,500. The Tax Court held $239,000 to be reasonable compensation in 1989.

g. The corporation paid no dividends in either fiscal year.

h. The case is appealable to the Ninth Circuit.

i. The five factors mentioned in determining reasonable compensation according to Elliott's are: (1) the employee's role in the company, (2) external comparison of the employee's salary with those paid by similar companies for similar services, (3) character and condition of the company, (4) conflict of interest in the employee's relationship to the corporation, and (5) the internal consistency in the company's treatment of payments to employees.

C:1-64 Judicial authority exists to exclude the Medicare payments from the amount the mother is treated as having provided for her own support. The IRS agrees with this authority; therefore, if the IRS audits the client's return, the IRS will not argue that Josh's mother provided the majority of her own support. (This information should be included in the client letter.)

The work papers should include a discussion of the authorities summarized below. Section 152(a) provides that one of the tests for claiming another as a dependent is to provide over one-half of such person's support. (Note: Josh's mother's gross income of $2,000 is not too high in the current year for her to be claimed his dependent assuming all other requirements are met.) If he provides over one-half of her support, he also may deduct any medical expenses he pays on her behalf. Section 152 does not define "support." Regulation Sec. 1.152-1(a)(2) states that support includes "food, shelter, clothing, medical and dental care, education, and the like." It also provides that in determining the amount an individual contributes to his own support, one must count the cost of support items paid for from "income, which is ordinarily excludable from gross income, such as benefits received under the Social Security Act."

In Alfred H. Turecamo v. CIR, 39 AFTR 2d 77-1487, 77-1 USTC ¶9415 (2nd Cir., 1977), the court held that hospital costs paid by Basic Medicare do not constitute support the ill person furnishes for himself or herself. After studying the legislative history of the Medicare statute, the court could find no valid basis "for distinguishing between hospital benefits received under Part A of Medicare [Basic Medicare] and either private insurance proceeds or supplemental benefits received under Part B [of Medicare]."

In Rev. Rul. 70-341, 1970-2 C.B. 31, the IRS ruled that Basic Medicare payments on a person's behalf must be treated as contributions by such person toward his own support. Such treatment was in contrast to that of Supplemental Medicare, which the IRS viewed as in the nature of insurance proceeds, and not self-support. Revenue Ruling 64-223, 1964-2 C.B. 50, held that amounts paid by an insurance company for medical costs are disregarded in the support test.

In Rev. Rul. 79-173, 1979-1 C.B. 86, the IRS revoked Rev. Rul. 70-341. Thus, the IRS currently treats Basic Medicare payments consistently with Supplemental Medicare and ignores amounts received from either source for purposes of the support test. In Archer v. Comm. 73 T.C. 963 (1980), the court held that both medicare and medicaid are disregarded in the support test.

C:1-65 In determining whether the property is used "too much" for personal purposes so that Sec. 280A applies, use of the residence by Amy or by family members constitutes personal use, as does use by persons who pay less than fair rental value (Sec. 280A(d)(2)). Use by Amy when performing repairs and maintenance full-time is totally disregarded (Sec. 280A(d)(2)). For

purposes of allocating the expenses attributable to rental use, however, all the days on which the property is rented for fair rental value are considered, even if the property is rented to family members on some of these days (Prop. Reg. Sec. 1.280A-3(c)).

The total number of days rented at fair rental value – the numerator of the fraction used in the allocation – is determined as follows:

Days rented to sister	8
Days rented to cousin	4
Days rented to three families	120
Total	132

The denominator for allocating interest and taxes is in dispute. Per Prop. Reg. Sec. 1.280 A-3(d)(3), the denominator is the total number of days of actual use (exclusive of use by the owner for performing repairs). Thus, the denominator would be 146 (12 + 8 + 4 + 2 + 120). Case law supports using as the denominator the number of days in the year, or 365 days in this case for allocating interest and taxes. Dorrance D. Bolton v. CIR 51 AFTR 2d 83-305, 82-2 USTC ¶9,699, (9th Cir., 1982), affirming 77 T.C. 104 (1981), and Edith G. McKinney v. CIR 52 AFTR 2d 83-6281, 83-2 USTC ¶9,665 (10th Cir., 1983).

No dispute exists over the fraction to use for allocating repairs, insurance, and depreciation. It is the number of days rented at fair rental value divided by the total number of days of actual use, or 132/148 (Sec. 280A(e)(1)). Note: The denominator is 148 instead of 146 (as above) because, here, it includes the two days of use for repairs.

C:1-66 a. The principal issue in both cases was whether the corporation could deduct amounts paid as compensation to the spouse (ex-spouse) of a sole shareholder. This issue, in turn, depended on whether such compensation was "reasonable" under the circumstances.

b. The Tax Court considered a number of factors, including (1) the employee's qualifications and training, (2) the nature, extent, and scope of her duties, (3) responsibilities and hours involved, (4) the size and complexity of the business, (5) the results of the employee's efforts, (6) the prevailing rates for comparable employees in comparable businesses, (7) the scarcity of other qualified employees, (8) the ratio of compensation to the gross and net income of the business, (9) the salary policy of the employer to other employees, and (10) the amount of compensation paid to the employee in prior years.

c. The facts of these cases are similar in the following respect: in both cases, the taxpayers were corporations that claimed a deduction for payments made to the spouse or ex-spouse of a sole shareholder. The facts are different in these respects: (1) In Summit the IRS contended that only a portion of the salary payments were nondeductible; in J.B.S., it argued that none of the salary payments were deductible. (2) In Summit, the spouse performed extensive services for the firm; in J.B.S., the ex-spouse appears to have performed no services. (3) In Summit, the court took into consideration the corporation's rising profits; in J.B.S., the court did not. (In fact, the latter opinion does not mention the firm's profits or loss position). (4) In Summit, the payments did not appear to be motivated by tax avoidance. (Because the corporation paid substantial dividends to its sole shareholder, the payments to the spouse did not appear to be "disguised dividends"). In J.B.S., the payments did appear to be motivated by tax

avoidance. (Testimony indicated that some tax positions had been taken to minimize the corporation's tax liability).

C:1-67 The memorandum should supply the following answers:

a. Revenue Proc. 2014-6, I.R.B. 2014-1, 198 and Rev. Proc. 2014-4, I.R.B. 2014-1, 125, govern requests for determination letters.

b. Form 5300, "Application for Determination for Employee Benefit Plan," must be filed with the request.

c. The following information must be provided in the request:
   1. Complete statement of facts and other information
   2. Copies of all contracts, wills, deeds, agreements, instruments, plans, and other documents
   3. Analysis of material facts
   4. Statement regarding whether the same issue is in an earlier return
   5. Statement regarding whether the same or similar issue was previously ruled on or requested, or is currently pending
   6. Statement of supporting authorities
   7. Statement of contrary authorities
   8. Statement identifying pending litigation
   9. Statement identifying information to be deleted from the copy of determination letter for public inspection
   10. Signature by the taxpayer or authorized representative
   11. Names of authorized representatives
   12. Power of attorney and declaration of representative
   13. Penalties of perjury statement

d. Actions that must accompany the filing include payment of appropriate user fee and notification of interested parties.

e. The request must be filed at the following address:

   EP Determinations
   Internal Revenue Service
   P.O. Box 12192
   Covington, KY 41012-0192

"What Would You Do In This Situation?" Solution

Ch. C:1, p. C:1-35. Inconsistent Figures.

In this context, you have two professional duties: first, a duty of confidentiality to each client, and second, a duty to verify information that appears to be incorrect on its face. According to Statement No. 3 of the Statements on Standards for Tax Services, a CPA who is required to sign a tax return should consider information actually known to the CPA from the tax return of another client if (1) that information is relevant to the former return, (2) its consideration is necessary to properly prepare that return, and (3) the use of such information does not violate any rule of confidentiality. Here, (1) the information relating to each return is relevant to the other; (2) its consideration is necessary to properly prepare the other return; and (3) the use of such information does not violate any rule of confidentiality, *so long as the information is not disclosed to the other client.* Your considering the tax return information should lead you to believe that it is incorrect on its face; therefore, you have a duty to verify it.

Accordingly, without revealing the basis for your belief, you should request from each client documentary evidence of its respective claim. Such evidence should consist of a paid invoice, a canceled check, a signed or certified receipt, a bill of lading, or any other document that indicates the essential terms of the contract of sale.