

Federal Tax Research

10TH EDITION

Roby B. Sawyers

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Standard Tax Citations

Citations are presented for illustrative and prescriptive purposes. They do not necessarily track to actual documents.

Statutory

Constitution	U.S. Const. art. I, § 8, cl. 2. U.S. Const. amend, XIV, § 2.
Code	§ 101(b)(2)(B)(ii).
Public Laws	P.L. 112-240 (American Taxpayer Relief Act of 2012).

Administrative

Regulation	Reg. § 1.263(a)-1.
Treasury Decision	T.D. 9636.
Temporary Regulation	Reg. § 1.163-8T.
Proposed Regulation	Prop. Reg. § 1.263(g)-1.
Revenue Ruling	Rev. Rul. 2013-20, 2013-40 I.R.B. 272
Revenue Ruling (before 2009)	Rev. Rul. 96-58, 1996-2 C.B. 6
Revenue Procedure	Rev. Proc. 2013-30, 2013-36 I.R.B. 173.
Letter Ruling	Ltr. Rul. 2010027033.
Technical Advice Memo	TAM 200908050.
Notice	Notice 2010-50, 2010-27 I.R.B. 12.
Announcement	Announcement 2013-20, 2013-14 I.R.B. 761.

Judicial

Board of Tax Appeals: GPO reporter	<i>Estate of D. R. Daly</i> , 3 B.T.A. 1042 (1926).
Tax Court Regular: (temporary citation)	<i>Mehan, Marty</i> , 122 T.C. _____, No. 5 (2004).
Tax Court Regular: GPO reporter	<i>Mehan, Marty</i> , 122 T.C. 396 (2004).
Tax Court Memo: CCH: Thomson Reuters	<i>Dixon, Michel</i> , 78 T.C.M 462 (1999). <i>Dixon, Michel</i> , T.C. Memo 1999-310
Tax Court Summary Opinion:	<i>Indrit Iljazi</i> , T.C. Summary Opinion 2010-59.
District Court: West:	<i>Bohall, Patrick L.</i> , 602 F. Supp. 2d 187 (DCt. D.C., 2009)
CCH:	<i>Bohall, Patrick L.</i> , 2009-1 USTC ¶ 50,307 (DCt. D.C.)
Thomson Reuters:	<i>Bohall, Patrick L.</i> , 103 AFTR 2d 2009-1338 (DCt. D.C.)
Court of Federal Claims: West:	<i>Esposito v. U.S.</i> , 70 Fed. Cl. 558 (2006)
CCH:	<i>Esposito v. U.S.</i> , 2006-2 USTC ¶ 50,434 (Fed. Cl.)
Thomson Reuters:	<i>Esposito v. U.S.</i> , 97 AFTR2d 2006-1733 (Fed. Cl.)
Court of Appeals: West:	<i>Home of Faith</i> , 39 F.3d. 263 (CA-10, 1994).
CCH:	<i>Home of Faith</i> , 94-2 USTC ¶ 50,570 (CA-10).
Thomson Reuters:	<i>Home of Faith</i> , 74 AFTR2d 94-6913 (CA-10).

Supreme Court:

GPO: *U.S. v. Clintwood Elkhorn Mining Co., Et Al.*, 553
U.S. 1 (2008)

West: *U.S. v. Clintwood Elkhorn Mining Co., Et Al.*, 128
S. Ct. 1511 (2008)

CCH: *U.S. v. Clintwood Elkhorn Mining Co., Et Al.*,
2008-1 USTC ¶ 50,281 (USSC)

Thomson Reuters: *U.S. v. Clintwood Elkhorn Mining Co., Et Al.*, 101
AFTR 2d 2008-1612 (USSC)

Books

Sawyers, R., Raabe, W., Whittenburg, G., and Gill, S., 2014. *Federal Tax Research*, 10th ed. Mason, OH: South-Western.

Journals

Everett, J., Hennig, C., and Raabe, W., Converting a C Corporation Into an LLC, *Journal of Taxation* Vol. 113, No. 2 (August 2010).

Capitalization

Proper nouns and words derived from them are capitalized while common nouns are not. The names of specific persons, places, or things are proper nouns. All other nouns are common nouns. Examples of proper nouns include:

the Congress

the Code

Section 172(a)

Regulation § 1.102-1 or the Proposed Regulation (references to regulations in general do not need to be capitalized)

the Fifth Circuit

the Tax Court

a revenue ruling or a private letter ruling

Italics

In handwritten or typed papers underlining represents italics. The titles of books, magazines, newspapers, pamphlets and court cases are shown in italics. Examples of items that are italicized include:

The Wealth of Nations

Journal of Taxation

New York Times

Gregory v. Helvering

Note: Do not italicize the titles of legal documents such as the U.S. Constitution and the U.S. Code.

Federal Tax Research

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TENTH EDITION

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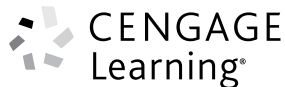
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Gerald E. Whittenburg, Steven L. Gill**

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Dedications

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Photo Courtesy of Roby B. Sawyers



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Photo Courtesy of William A. Raabe



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Photo Courtesy of Gerald E. Whittenburg



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Photo Courtesy of Steven L. Gill



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The Tenth Edition of *Federal Tax Research* includes the deepest analysis of the online research tools available to assist with tax and accounting research. As a result, we believe that the Tenth Edition is indispensable to learning and performing real-world research. New features in the Tenth Edition include:

- A research-case-classification matrix for all chapters with research cases. The new matrix classifies all research cases in the book by primary tax law source (legislative, administrative, judicial), jurisdiction (federal, state, international), entity type or issue, tax type, the similarity of the research case to the facts in the primary sources, the types of research sources needed to answer the case questions, and the expected student response (short paragraph, research memo, etc.).
- Cumulative research problems that continue from chapter to chapter.
- A complete reorganization of the Research Tools section of the book with separate chapters for Thomson Reuters Checkpoint and CCH IntelliConnect. Coverage and illustrations of research using BNA Bloomberg, Westlaw, and LexisNexis have been combined into a third chapter, with state and international tax services combined into a fourth chapter on multijurisdictional tax issues.
- Additional updated examples of tax research memos and client letters.
- Updates of rules affecting tax practice, including Circular 230 revisions and regulations, the AICPA Statements on Standards for Tax Services (SSTS), CPA mobility across states, and recent IRS litigation concerning registered tax-return preparers.
- Updated information on tax and research on the CPA exam as well as on conducting searches at irs.gov.
- Increased focus on tax planning, including the importance of considering both parties in a transaction and examples of calculating marginal tax rates in the presence of net operating losses.

The book has been prepared as a comprehensive, stand-alone reference tool for the user who wishes to become proficient in federal, multistate, and international tax research as well as financial accounting research. It is written for readers who are familiar with the fundamentals of the tax law, at a level that typically is achieved on the completion of two comprehensive introductory courses in taxation in either the accounting program in a business school or second- or third-year courses in a law school. Nearly every accounting, tax, and tax law student can benefit from the tools and strategies found in this book. The text is most appropriate for:

- Upper-level accounting students in a business school (i.e., seniors in a four-year program or those in the fifth year of a 150-hour program) who desire additional information concerning the practice of taxation.
- Students enrolled in a non-tax graduate program in business administration (e.g., an MBA or MS-management program) and would like further practical training in the functions of taxation in today's business environment.

- Second- or third-year law school students, especially those who desire a more detailed and pragmatic introduction to a specialized tax practice.
- Students commencing a graduate degree program in taxation, in either a business school or a law school, and require a varied and sophisticated introduction to the procedures of tax research and to the routine functions and implications of a tax practice.
- Practicing accountants and attorneys who need an introduction, an update, or a refresher concerning tax practice and research as an element of their career paths.

Structure and Pedagogy

Too often, existing textbooks ignore the detailed, pragmatic approach that students require in developing effective and efficient tax research skills. That is why we have included an unprecedented degree of hands-on tax research analysis throughout the text. This book does not simply discuss tax research procedures or the sources of the tax law nor does it provide a mere sample of the pertinent tax reference material. Rather, the book reflects our conviction that students learn best by active learning and real-world experience using the most comprehensive and important sources of tax law. We have applied this conviction to the many important features of the Tenth Edition, including:

- Dozens of exercises, problems, and research cases in each chapter.
- “Spotlight on Taxation” boxes in every chapter to provide additional research tips, news, and background information to students.
- Chapters on working with the IRS and on tax practice and administration that provide details on important topics such as preparer penalties, statutes of limitations, and the IRS audit and appeals process.
- Assignments requiring students to construct case briefs, file memos, client letters, and other elements of a comprehensive client file—vital communication skills they will need in practice.
- Hundreds of reproductions, illustrations, and screen captures from the most important tax reference materials to expose students to the real world of tax research.
- Summary charts, diagrams, and other study aids integrated throughout the text.

Other important features for students and instructors include the following:

- The “Quiz Yourself” feature at the end of each chapter directs students to the online quizzes located on the book’s Web site through www.cengagebrain.com. Here, students will have access to online quizzes, complete with immediate answers and feedback for questions answered incorrectly. The feedback will direct students to the section of the chapter that contains the correct answer.

Students can also access chapter-by-chapter study content at the CengageBrain.com home page and can search by author name, title (*Federal Tax Research*), or ISBN (1285439392) using the search box at the top of the page. This will bring readers to a link for the tenth edition of *Federal Tax Research*.

The instructor’s portion of the Web site for the text, located at www.cengagebrain.com, includes the solutions for the end-of-chapter material, a test bank, instructor PowerPoint slides, lecture notes, and the new research case classification matrix to help guide instructors through the course.

Using the Text

The main tax services are reviewed in a hands-on manner. Learning how to use the services is explained through example projects that guide the reader with step-by-step explanations and screen shots to illustrate what is actually seen on the screen. The text's exercises, cases, and advanced cases offer enough variety in both difficulty and subject matter that they may be assigned to individual readers, or to student groups of two or three, for their optimal use. The instructor also should consider giving each student in the course a different research case to complete, thereby discouraging joint work.

Given both the nature of the tax research process and the limited tax research databases available to most firms and universities, the instructor must take care to assign discussion materials for which the necessary resources are available and also to work through the assignment himself or herself, to ascertain that one's target solution to the assignment reflects the very latest in the development of the federal tax law.

The instructor may want to defer the assigning of certain research cases until a specific research service is discussed, which will provide additional illustrations. Alternatively, the reader could be encouraged to rework a previous assignment as specific research services are introduced.

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PART I

The Tax Research Environment

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Introduction to Tax Practice and Ethics

LEARNING OBJECTIVES

- Describe the elements of modern tax practice in the United States.
- Distinguish between open and closed transactions.
- Recall the sources of legal and ethical standards that guide those who engage in tax practice.
- Explain the major collections of ethical standards that bear upon tax practitioners today.
- Organize tax issues in a broader context of ethics and morality.
- Summarize the limitations on tax research by CPAs and other nonattorneys.

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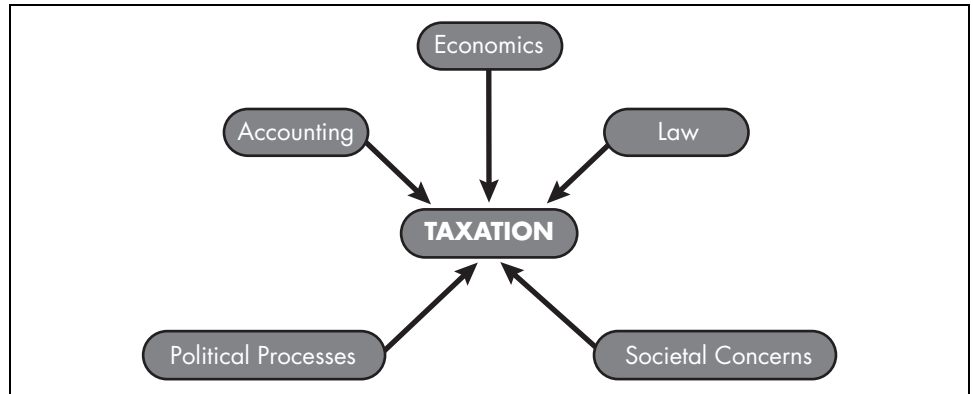
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TAX PRACTICE AND TAX RESEARCH have evolved over the last twenty or thirty years into an electronic and often paperless system. For example, in 2012 more than 80 percent of individual taxpayers e-filed their tax returns. In keeping with this continuing transition to an all-electronic tax system, today tax research is almost 100 percent online based. The Uniform CPA Exam recognizes this transition and includes a set of simulation questions that require the candidate to demonstrate accounting and tax research skills by completing short research cases using online searches of authoritative literature, including the Accounting Standards Codification (ASC) and the Internal Revenue Code (I.R.C.). However, before the tax practitioner can complete a tax research project, he or she must understand the tax research process and all its elements and how each element relates to solving a specific tax problem. The primary purpose of this book is to inform the user on how to effectively obtain tax research results in a timely and efficient manner.

The practice of taxation is the process of applying the tax laws, rules, regulations, and judicial rulings to specific transactions in order to determine the tax consequences to the taxpayer involved. There are many ways to practice tax. Certified public accountants (CPAs), tax attorneys, and enrolled agents often provide compliance and planning services for clients. In addition, tax can be practiced by controllers, chief financial officers (CFOs), tax directors, and other individuals who do tax work as part of their duties within a corporation or other business entity. An understanding of taxation and the tax practice environment is essential to the individual who wants to have a career in the tax area.

Taxation is the process of collecting revenue from citizens to finance government activities. In a modern technological society such as that of the United States, however, taxation comprises an interaction among several disciplines that is far from simple. The tax system is derived from law, accounting, economics, political science, and sociology (Exhibit 1-1). Principles of economics, sociology, and political science provide the environment, while law and accounting precepts are applied in a typical tax practice.

Tax policy questions concerning the effects that a specified tax law change will have on economic growth, the effects of projected inflation on the implementation of the tax law and vice versa, and the effects of the tax law on the United States' balance of payments are addressed by economists. Political scientists, economists, and sociologists examine issues such as who bears the ultimate burden of a tax, how a tax bill becomes law (including practical effects of the legislative process), the social equity of a tax, and whether a tax is discriminatory. Attorneys interpret taxation statutes, and accountants apply the tax laws to current or prospective economic transactions.

EXHIBIT 1-1: Elements of Taxation

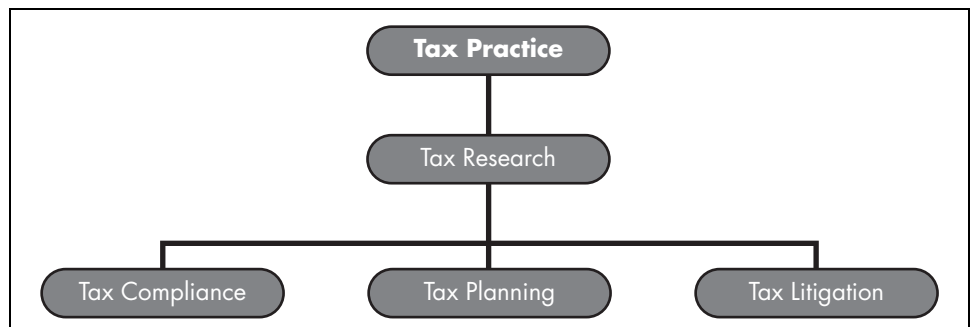
Elements of Tax Practice

The tax laws of a democratic country such as the United States are created by a political process. In recent years, the result of this political process has been a set of laws that levies taxes on income, sales, estates, gifts, and other items that usually are reflected by the accounting process. Modern tax practice can be separated into three elements: compliance, planning, and litigation, which are all supported by tax research. How these elements of tax practice fit together is illustrated in Exhibit 1-2.

Tax Compliance

In general, **tax compliance** consists of two separate but related components—tax return preparation and, for certain corporate entities, the preparation of the tax provision on a company’s financial statements.

Tax return preparation consists of the gathering of pertinent information, the evaluation and classification of such information, and the filing of necessary tax returns with the appropriate governmental agency. In the United States, this will typically be the Internal Revenue Service (IRS) or the appropriate state agency. Tax compliance also includes other functions necessary to satisfy governmental requirements, such as representation at a client’s IRS audit. Registered tax return preparers, enrolled agents (EAs),

EXHIBIT 1-2: Elements of Tax Practice

attorneys, and CPAs all perform tax compliance to some extent. Relatively simple individual, partnership, and corporate tax returns often are completed by registered tax return preparers. EAs, attorneys, and CPAs usually are involved in the preparation of more complex tax returns; in addition, they provide tax-planning services and represent their clients before the IRS.

A corporation's income tax expense as reported on its financial statements is often different from the income tax on its tax return. Financial statements are prepared using generally accepted accounting principles (GAAP) rather than tax law as set out in the Internal Revenue Code, related Treasury Regulations, and other administrative pronouncements and court cases. Both tax return preparation and the preparation of the tax provision on financial statements are examined in more detail in later chapters.

Tax Planning

Tax planning is the process of arranging one's financial affairs to minimize tax liabilities. While this usually means minimizing current tax payments, that is not always the case. Whereas **tax avoidance** is a legitimate objective of modern tax practice, **tax evasion** constitutes the illegal nonpayment of a tax and cannot be condoned. Fraudulent acts of any kind are unrelated to the professional practice of tax planning.

Tax planning can be divided into two major categories: **open transactions** and **closed transactions**. In an open transaction, the tax practitioner maintains some degree of control over the potential tax liability because the transaction is not yet completed; for example, the title to an asset has not yet passed. If desired, some modifications to an incomplete transaction can be made to receive more favorable tax treatment. In a closed transaction, however, all of the pertinent actions have been completed; therefore, tax planning may be limited to the presentation of the facts to the government in the most favorable, legally acceptable manner possible.



SPOTLIGHT ON TAXATION

Case Quotation

There is nothing inherently illegal or immoral in the avoidance of taxation (i.e., tax planning) according to the tax system's rules. The eminent judge Learned Hand best expressed this doctrine in the dissenting opinion of *Commissioner v. Newman*, 159 F.2d 848 (CA-2, 1947):

Over and over again, courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced extractions, not voluntary contributions.

Tax Litigation

A specialized area within the practice of taxation is the concentration on **tax litigation**. Litigation is the process of settling a dispute with another party (in the United States, usually the IRS or a state revenue department) in a court of law. Typically, a tax attorney handles tax litigation that progresses beyond the initial appeal of an IRS or state revenue department audit result. Accountants and other financial advisers can also serve in a support capacity. Later chapters of this book contain additional discussions of the various opportunities and strategies available in tax litigation.

Tax Research

Tax research is undertaken to answer taxation questions. The tax research process includes the (1) identification of pertinent issues, (2) determination of proper authorities, (3) evaluation of the appropriateness of these authorities, and (4) application of these authorities. Tax research methodology, sources of federal tax law, and tax research tools are examined in Chapters 2 through 8 of this book.

Rules and Ethics in Tax Practice

A person who prepares tax returns for monetary or other compensation, or who is licensed to practice in the tax-related professions, is subject to various statutes, rules, and codes of professional conduct. Tax practitioners (as defined by the IRS) are regulated by **Circular 230**, Regulations Governing Practice before the Internal Revenue Service.

The ethical conduct of an attorney is also governed by the laws of the state(s) in which he or she is licensed to practice. Most states have adopted, often with some modification, guidelines that are based on the **American Bar Association (ABA)** Model Rules of Professional Conduct.

Certified public accountants (CPAs) who are members of the **American Institute of Certified Public Accountants (AICPA)** must follow its Code of Professional Conduct and any other rules generated by the state board(s) of accountancy. The AICPA has also produced a series of Statements on Standards for Tax Services (SSTS), which contain advisory guidelines for AICPA members who prepare tax returns. Although CPAs who are not members of the AICPA are not bound by the Code of Professional Conduct and the SSTS, those rules and standards are a useful source of guidance for all members of the profession. In addition, CPAs are regulated by the state(s) in which they are licensed. As a result, there can be additional statutes, regulations, and requirements that must be met by individuals who practice in certain states.

Statutory tax law also specifies certain penalties and other rules of conduct that apply to all tax return preparers. Chapter 14 addresses these rules.

The basic overlapping sources of rules and ethics for tax practitioners are illustrated in Exhibit 1-3.

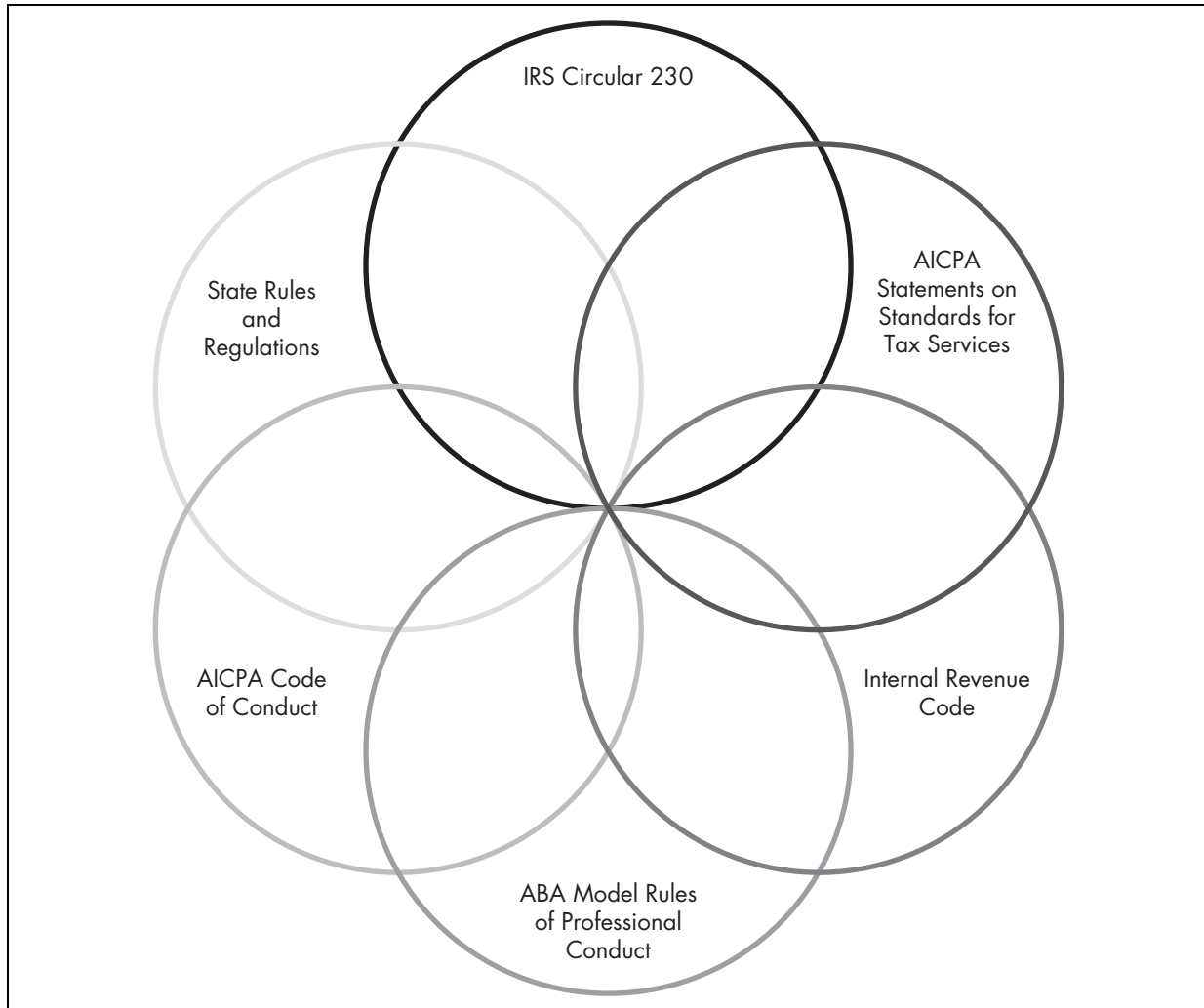
Circular 230

Circular 230, which constitutes Part 31 of the Treasury Department Regulations, is designed to provide protection to taxpayers and the IRS by requiring tax preparers to be technically competent and to adhere to **ethical standards**.¹ In 2011, the IRS issued final regulations (T.D. 9527) that made previously unenrolled return preparers (return preparers who are not attorneys, CPAs, or EAs) who prepare and file tax returns for compensation subject to Circular 230 for the first time. These individuals are referred to as registered tax return preparers. However, a court battle ensued in which three tax return preparers argued that the IRS had no authority to regulate their preparation of tax returns. In January 2013, the District Court for the District of Columbia stopped the IRS from enforcing the regulations.² In March 2013, the U.S. Court of Appeals for the District of Columbia Circuit denied the IRS's motion to stay the injunction halting the return preparer regulation program. The IRS appealed the lower court ruling. The Court of Appeals heard oral argument on September 24, 2013.³

¹Circular 230 can be found on the IRS's Website at www.irs.gov/pub/irs-pdf/pcir230.pdf.

²*Loving*, No. 12-385 (D.D.C. Jan. 18, 2013).

³*Loving v. IRS* No. 13-5061 (D.C. Cir. Argued Sept. 24, 2013).

EXHIBIT 1-3: Sources of Rules and Ethics for Tax Practitioners

At present, Circular 230 contains the following definition of **practice before the IRS** in Section 10.2 of Subpart A:

Practice before the Internal Revenue Service comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing documents; filing documents; corresponding and communicating with the Internal Revenue Service; rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion; and representing a client at conferences, hearings, and meetings.

Who May Practice [Circular 230 § 10.3] Under Section 10.3, Subpart A, of Circular 230, the following individuals may practice before the IRS:

1. Attorneys
2. Certified Public Accountants (CPAs)
3. Enrolled agents (EAs)
4. Enrolled actuaries
5. Enrolled retirement plan agents
6. Registered tax return preparers

These individuals are collectively referred to as Circular 230 practitioners.

In order to practice before the IRS, an attorney must be a member in good standing of the bar of the highest court in any state, possession, territory, or commonwealth or the District of Columbia. Likewise, CPAs and enrolled actuaries must be qualified to practice in any state, possession, territory, or commonwealth or the District of Columbia. No further substantive examination is required.



SPOTLIGHT ON TAXATION

CPA Mobility

While CPAs are licensed by their home state, a uniform system allowing CPAs to practice across state lines has been endorsed by the AICPA and the National Association of State Boards of Accountancy (NASBA). A total of 49 states and the District of Columbia have passed mobility laws that essentially allow a CPA with a license from one state to practice outside his or her home state without getting an additional license in the state in which he or she will be serving a client.

Individuals who are not attorneys or CPAs can qualify to practice before the IRS by becoming an **enrolled agent (EA)**. An EA is someone who has either passed a special IRS examination or worked for the IRS for five years. The procedures for becoming an EA are detailed in Circular 230, Subpart A, §§ 10.4, 10.5, and 10.6. EAs have the same rights as attorneys and CPAs to represent clients before the IRS. Under Circular 230, an EA must renew his or her enrollment card on a three-year cycle.

The Enrolled Agent Special Enrollment Examination (SEE) is an online exam given throughout the year that consists of three parts covering individual taxation, business taxation and representation, and practices and procedures. For additional information on the SEE, see the Prometric Testing Website: <https://www.prometric.com/en-us/clients/SEE/Pages/landing.aspx>.

For each enrollment cycle, EAs, like attorneys and CPAs, must meet certain continuing education requirements as defined in Subpart A, § 10.6. For an EA's enrollment card to be renewed, he or she must complete 72 hours (i.e., an average of 24 hours per year) of qualifying continuing education for each three-year enrollment period. In addition, a minimum of 16 hours of continuing education credit must be completed during each year of an enrollment cycle. Subpart A, § 10.6(f) defines what qualifies as continuing education for EAs.

For more information on EAs, see www.irs.gov/taxpros/agents and www.naea.org.