⋆ CHAPTER TWO ⋆

TAX PRACTICE AND RESEARCH

LEARNING OBJECTIVES

Upon completion of this chapter you will be able to:

- Describe the basic features of tax practice: compliance, planning, litigation, and research
- Identify typical career paths in taxation
- Understand the rules of conduct that must be followed by those who perform tax services
- Appreciate the role of ethics in tax practice and the responsibilities of tax practitioners
- Explain the key penalties that influence positions taken on tax returns
- Describe the process in which Federal tax law is enacted and subsequently modified or evaluated by the judiciary
- Interpret citations to various statutory, administrative, and judicial sources of the tax law
- Identify the source of various administrative and judicial tax authorities
- Locate most statutory, administrative, and judicial authorities
- Evaluate the relative strength of various tax authorities
- Understand the importance of communicating the results of tax research

CHAPTER OUTLINE

INTRODUCTION

Before jumping into the rules and regulations that must be applied to determine the taxpayer's tax liability, one should have at least an appreciation of the basic nature of tax practice and how to go about finding answers to tax questions. This chapter lays the necessary foundation by first exploring exactly what it is that tax professionals do and the rules of conduct that they must observe while doing it. The chapter concludes by identifying the various sources of tax law and how they may be accessed and used to solve a particular tax question.

TAX PRACTICE IN GENERAL

There are essentially four aspects of tax practice: compliance, planning, litigation, and research. Although these may be thought of as discrete areas, as a practical matter, tax professionals are normally involved in all four.

Tax Compliance. The area of tax compliance generally encompasses all of the activities necessary to meet the statutory requirements of the tax law. This largely involves the preparation of the millions of tax returns that must be filed by individuals and other organizations each year. Interestingly, the reliance of individuals on professional return preparation is rather a recent phenomenon. There was a time when most individuals prepared their own returns and H&R Block was unheard of. However, the ever-increasing complexity of the tax law has made professional assistance almost a necessity and in fact created a tax preparation industry. In 2002, 56 percent of all the individual tax returns filed were completed by a paid preparer.[1] Tax preparation services are typically

[1] See "Paid Tax Return Preparers," Testimony Before U.S. Senate Finance Committee, GAO -06-563T (April 4, 2006).

performed by Certified Public Accountants (CPAs), attorneys, enrolled agents (individuals who have passed a two-day examination given by the IRS), and commercial tax return preparation services. But there are no special requirements that must be met to become a tax return preparer. Consequently, anyone willing to try his or her hand at mastering the tax law—as well as any shysters who think there is a buck to be made—can hang out a shingle. In fact, the advent of personal computers and sophisticated yet user-friendly software have made tax preparation easier for everyone, including those who want to get into the tax preparation business. Note, however, that only CPAs, attorneys, and enrolled agents are authorized to practice before the IRS and are therefore able to represent taxpayers beyond the initial audit (e.g., at the Appellate level).

As might be imagined, the day-to-day tasks of those working in the tax compliance area typically surround preparation of a tax return. They collect the appropriate information from the taxpayer and then analyze and evaluate such data for use in preparing the required tax return or other tax filing. But tax compliance goes far beyond merely placing numbers in boxes. In many cases, completion of the return requires tax research to determine the appropriate treatment of a particular item. Preparation of a return may also uncover tax planning opportunities that can be shared with the client to obtain future savings. In addition, tax compliance involves representation of the taxpayer before the IRS during audits and appeals.

Tax Planning. Perhaps the most rewarding part of tax practice is tax planning and the sense of satisfaction one gets from helping clients minimize their tax liability. As explained in the previous chapter, tax planning is simply the process of arranging one's financial affairs in light of their potential tax consequences. Unlike the weather, taxpayers often have some degree of control over their tax liability, and it is the job of the tax adviser to help the taxpayer whenever possible. A great deal of tax planning is simply an outgrowth of the tax compliance process. Well-trained tax professionals often recognize a situation where a little planning could have brought a more favorable result. In these so-called *closed fact* situations, it is typically too late to do anything until the opportunity once again presents itself, typically the next year. On the other hand, taxpayers about to embark on a transaction—an *open fact* situation—may engage a tax adviser to determine the tax consequences and how to structure the transaction to obtain the most beneficial outcome.

Tax Litigation. As might be expected, taxpayers and the IRS do not always agree on the tax treatment of a particular item. Many disputes and controversies are settled during an appeals process within the IRS itself. Others, however, are ultimately resolved in a court of law. Tax litigation is a very specialized but often lucrative area of tax practice. In most cases, tax litigation is conducted only by licensed attorneys. However, accountants and others, including the taxpayer himself, can represent the taxpayer in certain situations. In addition, accountants often assist legal counsel and provide litigation support.

Tax Research. Most practitioners believe that tax research is the most interesting part of tax practice. Tax research is simply the process of obtaining information and synthesizing it to answer a particular tax question. Regardless of the area of tax practice—compliance, planning, or litigation—tax research plays an important part.

Tax research generally involves identifying tax issues, finding relevant information on the issues, and assessing the pertinent authority to arrive at a conclusion. Unfortunately, the law is not so straightforward that the answer to any tax question is readily available. Consequently, being able to do the research is an important skill for anyone involved in tax. For example, a decorator that works out of her home may want to know whether the cost of maintaining a home office can be deducted in computing taxable income. It may seem that a common problem like this could be easily resolved, but it is often much more difficult than might be imagined. To answer this question, the tax adviser may be required to sift through mounds of information—rules, regulations, IRS pronouncements, and court cases—in order to determine the proper treatment. Even if an answer seems apparent, the dynamic nature of the tax law often requires the practitioner to constantly update his or her research to ensure that it is current and has not been changed by some recent development.

TAXATION AS A PROFESSIONAL CAREER

The need for tax advisory services has grown almost exponentially in recent years. The growth is not surprising given the growth in the tax law. Over the past 35 years, there have been tax law changes virtually every year. During this time Congress has turned to the tax system again and again to attack not only the country's economic ills but its social problems as well. The end result is a tax law, both Federal and state, that is forever changing and quite complex. Consequently, individuals and organizations have increasingly needed to call upon tax specialists to help them cope with the law. These demands on the tax profession have created tremendous opportunities for those interested in careers in taxation.

The tax specialists of today wear a number of hats. They act as tax consultants as well as business advisers. They help individuals and business owners with tax compliance, keep them informed of changes in the tax law, and assist them in personal financial planning. Tax advisers not only consult on Federal and state income tax matters; they also prepare sales, payroll, and franchise tax returns. Industry and government also employ tax specialists who are involved in planning and compliance. Here are some examples of activities in which the tax specialist might be involved:

- A husband and wife want to transfer their business to their children. Should they sell the business to the kids or would they be better off just giving it to them? A tax specialist can compare the income tax consequences of a sale to that of a gift or bequest and help design the best plan in light of the couple's wishes.
- A taxpayer wants to sell her corporation. Should she sell the stock or cause the corporation to sell its assets? A tax specialist can explain the tax and nontax factors affecting the decision.
- An individual and his son are forming a new business. Should it be operated as a corporation, an S corporation, a partnership, or a limited liability company? A tax specialist can help with the analysis.
- A corporation is planning on opening operations in a foreign country. A tax specialist can help reorganize the company to help minimize U.S. and foreign taxes.
- A corporation is considering the establishment of a retirement plan. A tax adviser who specializes in employee benefits can provide information regarding the tax considerations.
- A taxpayer is seeking a divorce. A tax specialist can explain the tax consequences.
- A corporation and its subsidiaries are thinking about filing a consolidated tax return. The tax specialist can assist the taxpayer in filing such a return, preparing estimated tax payments, or reviewing a corporation's tax returns.
- The IRS wants to deny the taxpayer a deduction for meals and entertainment. The tax specialist might represent an individual during the IRS examination or present oral and written arguments before an IRS appeals conference and (if qualified) before the U.S. Tax Court.

In these and similar matters, the tax specialist is often an important member of the client's professional advisory team and works with other high-caliber individuals to minimize client costs. For example, if a business owner is seeking estate planning advice, the team typically includes the individual's attorney, accountant, life insurance agent, and tax adviser.

Thousands of men and women enjoy successful careers in taxation. They are highly respected as professionals and are well compensated for their work. Those in tax rarely find their jobs boring or dull. Tax work, particularly once one has paid one's dues and built a firm foundation, is interesting and challenging. Moreover, working in a tax department along with other professionals with like interests can be a vastly rewarding personal experience. Tax professionals also serve the public good by raising the standard of tax practice and administration and by working with other groups to improve the tax system.

SOURCES AND APPLICATIONS OF TAX LAW

As stated at the outset of this chapter, before delving into the rules and regulations of taxation, it is important at a minimum to have an appreciation of not only the nature of tax practice but also the sources of the tax law and how they can be used for solving questions. The second half of this chapter identifies the various components of the tax law, explains how they can be accessed, and reviews the basic methods of tax research.

AUTHORITATIVE SOURCES OF TAX LAW

Sources of tax law can be classified into two broad categories: (1) the law, and (2) official interpretations of the law. The law consists primarily of the Constitution, the Acts of Congress, and tax treaties. In general, these sources are referred to as the *statutory* law. Most statutory law is written in general terms for a typical situation. Since general rules, no matter how carefully drafted, cannot be written to cover variations on the normal scheme, interpretation is usually required. The task of interpreting the statute is one of the principal duties of the Internal Revenue Service (IRS) as representative of the Secretary of the Treasury. The IRS annually produces thousands of releases that explain and clarify the law. To no one's surprise, however, taxpayers and the government do not always agree on how a particular law should be interpreted. In situations where the taxpayer or the government decides to litigate the question, the courts, as final arbiters, are given the opportunity to interpret the law. These judicial interpretations, administrative interpretations, and the statutory law are considered in detail below.

STATUTORY LAW

The Constitution of the United States provides the Federal government with the power to tax. Disputes concerning the constitutionality of an income tax levied on taxpayers without apportionment among the states were resolved in 1913 with passage of the Sixteenth Amendment. Between 1913 and 1939, Congress enacted revenue acts that amounted to a complete rewrite of all tax law to date, including the desired changes. In 1939, due primarily to the increasing complexity of the earlier process, Congress codified all Federal tax laws into Title 26 of the *United States Code*, which was then called the *Internal Revenue Code of 1939*. Significant changes in the Federal tax laws were made during World War II and the postwar period of the late 1940s. Each change resulted in amendments to the 1939 Code. By 1954, the codification process had to be repeated in order to organize all additions to the law and to eliminate obsolete provisions. The product of this effort was the *Internal Revenue Code of 1954*. After 1954, Congress took great care to ensure that each new amendment to the 1954 Code was incorporated within its organizational structure with appropriate cross-references to any prior provisions affected by a new law. In 1986, Congress again made substantial revision in the tax law. Consistent with this massive redesign of the 1954 Code, Congress changed the title to the *Internal Revenue Code of 1986*. Like the 1954 Code, the 1986 Code is subject to revisions introduced by a new law. Recent changes incorporated into the 1986 Code include the Small Business and Work Opportunity Tax Act of 2007, the Tax Increase Prevention Act of 2005, the Mortgage Forgiveness Debt Relief Act of 2007.

The legislative provisions contained in the Code are by far the most important component of tax law. Although procedure necessary to enact a law is generally well known, it is necessary to review this process with a special emphasis on taxation. From a tax perspective, the *intention* of Congress in producing the legislation is extremely important since the primary purpose of tax research is to interpret the legislative intent of Congress.

THE MAKING OF A TAX LAW

Article I, Section 7, Clause 1 of the Constitution provides that the House of Representatives of the U.S. Congress has the basic responsibility for initiating revenue bills.[2] The Ways and Means Committee of the House of Representatives must consider any tax bill before it is presented for vote by the full House of Representatives. On bills of major public interest, the Ways and Means Committee holds public hearings where interested organizations may send representatives to express their views about the bill. The first witness at such hearings is usually the Secretary of the Treasury, representing the President of the United States. In many cases, proposals for new tax legislation or changes in existing legislation come from the President as a part of his political or economic programs.

After the public hearings have been held, the Ways and Means Committee usually goes into closed session, where the Committee prepares the tax bill for consideration by the entire House. The members of the Committee receive invaluable assistance from their highly skilled staff, which includes economists, accountants, and lawyers. The product of this session is a proposed bill that is submitted to the entire House for debate and vote.

After a bill has been approved by the entire House, it is sent to the Senate and assigned to the Senate Finance Committee. The Senate Finance Committee may also hold hearings on the bill before its consideration by the full Senate. The Senate's bill generally differs from the House's bill. In these situations, both versions are sent to the Joint Conference Committee on Taxation, which is composed of members selected from the House Ways and Means Committee and from the Senate Finance Committee. The objective of this Joint Committee is to produce a compromise bill acceptable to both sides. On occasion, when compromise cannot be achieved by the Joint Committee or the compromise bill is unacceptable to the House or the Senate, the bill "dies." If, however, compromise is reached and the Senate and House approve the compromise bill, it is then referred to the President for his or her approval or veto. If the President vetoes the bill, the legislation is "killed" unless two-thirds of both the House and the Senate vote to override the veto. If the veto is overridden, the legislation becomes law.

When a bill is signed into law by the President it is sent to the Office of the Federal Register to be assigned a "public law number." For example, the Tax Reform Act of 1986 is designated P.L. 99-514 and is explained in the following diagram.

[2] Tax bills do not originate in the Senate, except when they are attached to other bills.

Citation P.L. 99- 514

Public Law

"99" is the session of Congress that passed the Act

"514" is the 514th public bill adopted by Congress of that two year session

References to the various laws are often made using their public law numbers. Unfortunately, the public law number does not indicate the year in which the bill was enacted. However, the legislative session in which a public law was enacted can be determined using the following formula:

$$(\text{Session number} \times 2) - 112 = \text{Second year of session}$$

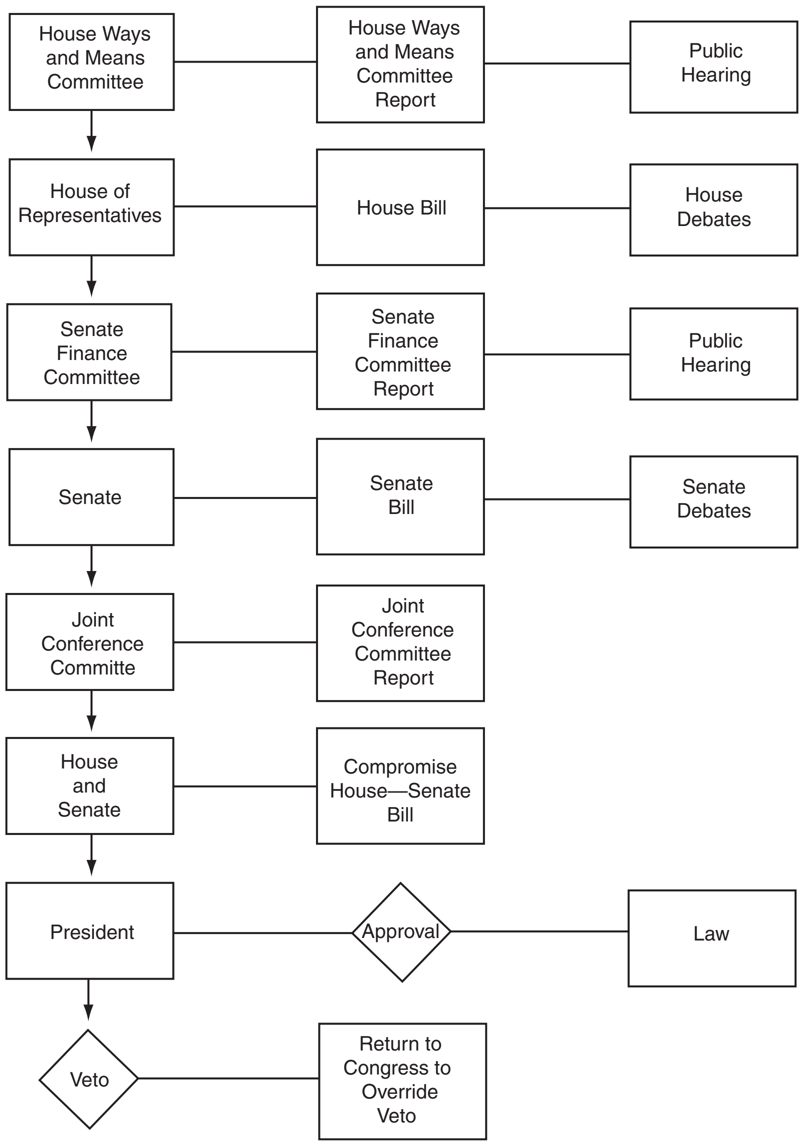
Using this formula, P.L. 99-514 was enacted during the 1985–1986 legislative session ($99 \times 2 = 198 - 112 = 86$). The Tax Relief and Health Care Act of 2006 was P.L. 109-432. Using the formula reveals that this Act was enacted during the 2005–2006 legislative session ($109 \times 2 = 218 - 112 = 106$)

COMMITTEE REPORTS

It should be noted that at each stage of the legislative process, information is produced that may be useful in assessing the intent of Congress. One of the better sources of Congressional intent is a report issued by the House Ways and Means Committee. This report contains the bill as well as a general explanation. This explanation usually provides the historical background of the proposed legislation along with the reasons for enactment. The Senate Finance Committee also issues a report similar to that of the House. Because the Senate often makes changes in the House version of the bill, the Senate's report is also an important source. Additionally, the Joint Conference Committee on Taxation issues its own report, which is sometimes helpful. Two other sources of intent are the records of the debates on the bill and publications of the initial hearings.

Committee reports and debates appear in several publications. Committee reports are officially published in pamphlet form by the U.S. Government Printing Office as the bill proceeds through Congress. The enacted bill is published in the *Internal Revenue Bulletin* and the *Internal Revenue Cumulative Bulletin*. The debates are published in the *Congressional Record*. In addition to these official government publications, several commercial publishers make this information available to subscribers.

The diagram below illustrates the normal flow of a bill through the legislative process and the documents that are generated in this process.



ORGANIZATION OF THE INTERNAL REVENUE CODE

Once a tax bill becomes tax law, it is incorporated into the existing structure of the U.S. federal laws known as the *United States Code*. As mentioned above, the *U.S. Code* is the collection of all laws enacted by Congress. Laws concerning the same subject matter (e.g., taxation) are consolidated in a single "title." As shown in Exhibit 2-1, there are 50 titles. Tax laws are incorporated directly into Title 26 entitled *Internal Revenue Code*.[3]

[3] All future use of the term Code or Internal Revenue Code refers to the *Internal Revenue Code of 1986*, as amended.

EXHIBIT 2-1
United States Code

TITLE NUMBER	TITLE NAME	TITLE NUMBER	TITLE NAME
Title 1	General Provisions	**Title 26**	**Internal Revenue Code**
Title 2	The Congress	Title 27	Intoxicating Liquors
Title 3	The President	Title 28	Judiciary and Judicial Procedure
Title 4	Flag and Seal, Seat Of Government, . . .	Title 29	Labor
Title 5	Government Organization and Employees	Title 30	Mineral Lands and Mining
Title 6	Domestic Security	Title 31	Money and Finance
Title 7	Agriculture	Title 32	National Guard
Title 8	Aliens and Nationality	Title 33	Navigation and Navigable Waters
Title 9	Arbitration	Title 34	Navy (repealed)
Title 10	Armed Forces	Title 35	Patents
Title 11	Bankruptcy	Title 36	Patriotic Societies and Observances
Title 12	Banks and Banking	Title 37	Pay and Allowances Of the Uniformed Services
Title 13	Census	Title 38	Veterans' Benefits
Title 14	Coast Guard	Title 39	Postal Service
Title 15	Commerce and Trade	Title 40	Public Buildings, Property, and Works
Title 16	Conservation	Title 41	Public Contracts
Title 17	Copyrights	Title 42	The Public Health and Welfare
Title 18	Crimes and Criminal Procedure	Title 43	Public Lands
Title 19	Customs Duties	Title 44	Public Printing and Documents
Title 20	Education	Title 45	Railroads
Title 21	Food and Drugs	Title 46	Shipping
Title 22	Foreign Relations and Intercourse	Title 47	Telegraphs, Telephones, and Radiotelegraphs
Title 23	Highways	Title 48	Territories and Insular Possessions
Title 24	Hospitals and Asylums	Title 49	Transportation
Title 25	Indians	Title 50	War and National Defense

Title 26 (the Internal Revenue Code) is further divided as follows:

Title 26 of the United States Code (referred to as the Internal Revenue Code)
Subtitle A—Income Taxes
Chapter 1—Normal Taxes and Surtaxes
Subchapter A—Determination of Tax Liability
Part I—Tax on Individuals
Sections—1 through 5

Exhibit 2-2 reveals the contents of the various subdivisions. As a practical matter, virtually all of a tax practitioner's work is done in Subtitle A, Chapter 1, which deals with income taxes. Note that subtitles are further divided into chapters, subchapters, parts, subparts and finally the most important element: sections.

EXHIBIT 2-2

Internal Revenue Code: Subtitles, Chapters, Subchapters

Subtitle	Subject	First Code Section
Subtitle A	Income Taxes	§ 1
Subtitle B	Estate and gift taxes	§ 2001
Subtitle C	Employment taxes	§ 3101
Subtitle D	Miscellaneous excise taxes	§ 4001
Subtitle E	Alcohol, tobacco, and certain other excise taxes	§ 5001
Subtitle F	Procedure and Administration	§ 6001
Subtitle G	The Joint Committee on Taxation	§ 8001
Subtitle H	Financing of Presidential election campaigns	§ 9001
Subtitle I	Trust Fund Code	§ 9501

Chapters in Subtitle A	Name	First Code Section
1	Income Taxes	§ 1
2	Tax on Self-Employment Income	§ 1401
3	Withholding of Tax on Nonresident Aliens and Foreign Corporations	§ 1441
4	[Repealed]	
5	[Repealed]	§ 1491
6	Consolidated Returns	§ 1501

Selected Subchapters of Chapter 1	Name	Code Sections
A	Determination of Tax Liability	§§ 1-59B
B	Computation of Taxable Income	§§ 61-291
C	Corporate Distributions and Adjustments	§§ 301-385
D	Deferred Compensation, Etc.	§§ 401-436
E	Accounting Periods and Methods of Accounting	§§ 441-483
F	Exempt Organizations	§§ 501-530
G	Corporations Used to Avoid Income Tax on Shareholders	§§ 531-565
H	Banking Institutions	§§ 581-597
I	Natural Resources	§§ 611-638
J	Estates, Trusts, Beneficiaries, and Decedents	§§ 641-692
K	Partners and Partnerships	§§ 701-777
L	Insurance Companies	§§ 801-848
M	Regulated Investment Companies and Real Estate Investment Trusts	§§ 851-860L
N	Tax Based on Income From Sources Within or Without the United States	§§ 861-999
O	Gain or Loss on Disposition of Property	§§ 1001-1111
P	Capital Gains and Losses	§§ 1201-1298
S	Tax Treatment of S Corporations and Their Shareholders	§§ 1361-1379

The most critical portions of the Internal Revenue Code are its "sections." The sections contain the laws—often referred to as provisions or rules—that a taxpayer must follow to determine taxable income and ultimately the final tax liability. For example, the starting point in determining taxable income is gross income and Code Section 61 provides the definition of gross income as follows: income. Section 61 appears below.

Section 61: Gross Income Defined

(a) **General definition. Except as otherwise provided in this subtitle (A), gross income means all income from whatever source derived, including (but not limited to) the following items:**

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
(2) Gross income derived from business;
(3) Gains derived from dealings in property
(4) Interest
(5) Rents
.
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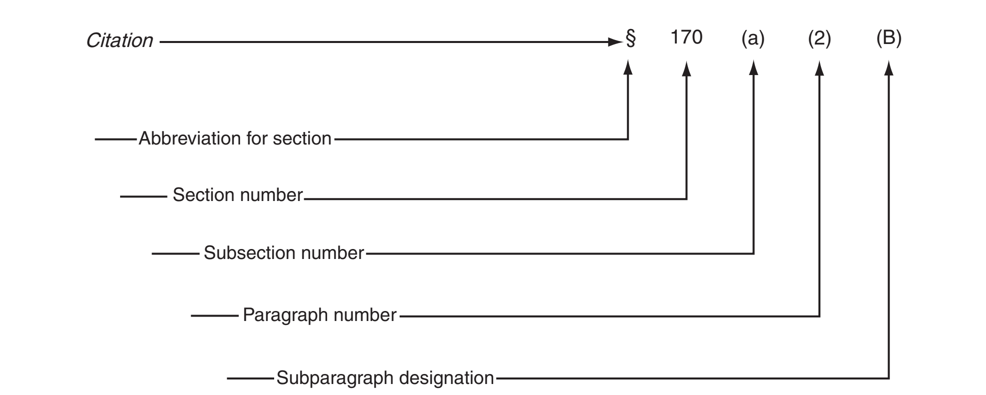
.
(14) Income in respect of a decedent and
(15) Income from an interest in an estate or trust.

The ability to use the Internal Revenue Code is essential for all individuals who have any involvement with the tax laws.

When working with the tax law, it is often necessary to make reference to, or *cite*, a particular source with respect to the Code. The *section* of the Code is the source normally cited. A complete citation for a section of the Code would be too cumbersome. For instance, a formal citation for Section 1 of the Code would be "Subtitle A, Chapter 1, Subchapter A, Part I, Section 1." In most cases, citation of the section alone is sufficient. Sections are numbered consecutively throughout the Code so that each section number is used only once. Currently the numbers run from Section 1 through Section 9833. Not all section numbers are used, so that additional ones may be added by Congress in the future without the need for renumbering.[4]

Citation of a particular Code section in tax literature ordinarily does not require the prefix "Internal Revenue Code" because it is generally understood that, unless otherwise stated, references to section numbers concern the Internal Revenue Code of 1986 as amended. However, since most Code sections are divided into subparts, reference to a specific subpart requires more than just its section number. Section 170(a)(2)(B) serves as an example.



[4] It is interesting to note that when it adopted the 1954 Code, Congress deliberately left section numbers unassigned to provide room for future additions. Recently, however, Congress has been forced to distinguish new sections by alphabetical letters following a particular section number. See, for example, Sections 280, 280A, 280B, and 280C of the 1986 Code.

All footnote references used throughout this text are made in the form given above. In most cases, the "§" or "§§" symbols are used in place of the terms "section" or "sections," respectively.

Single-volume or double-volume editions of the Internal Revenue Code are published after every major change in the law. Private publishing companies such as Commerce Clearing House, Inc. (CCH) and the Research Institute of America (RIA) publish these editions as well as a wealth of other tax information. All of this tax information is included in so-called tax services–massive tax libraries–compiled and published by these companies and others. The major tax services are discussed in a later section of this chapter.

TAX TREATIES

The laws contained in tax treaties represent the third and final component of the statutory law. Tax treaties (also referred to as tax conventions) are agreements between the United States and other countries that provide rules governing the taxation of residents of one country by another. For example, the tax treaty between the United States and France indicates how the French government taxes U.S. citizens residing in France and vice versa. Tax treaties, as law, have the same authority as those laws contained in the Code.[5] Treaty provisions may override provisions of the Internal Revenue Code if the treaty was signed after August 16, 1954.[6] For this reason, persons involved with an international tax question must be aware of tax treaties and recognize that the Code may be superseded by a tax treaty.

ADMINISTRATIVE INTERPRETATIONS

After Congress has enacted a tax law, the Executive branch of the Federal government has the responsibility for enforcing it. In the process of enforcing the law, the Treasury interprets, clarifies, defines, and analyzes the Code in order to apply Congressional intention of the law to the specific facts of a taxpayer's situation. This process results in numerous administrative releases including the following:

1. Regulations
2. Revenue rulings and letter rulings
3. Revenue procedures
4. Technical advice memoranda

REGULATIONS

Regulations are the Treasury's official interpretation of the Internal Revenue Code. To illustrate, consider the problem of a couple who discovered $4,467 of old currency in a piano seven years after they purchased it at an auction for $15.[7] Is this taxable income? Note that the definition of gross income contained in § 61 above provides little guidance, indicating only that "income is income from whatever source derived." However, one of the regulations explaining what constitutes gross income, Reg. § 1.61-14, indicates that buried treasure is to be included in income. Other regulations concerning gross income discuss in detail the treatment of such items as dividends, interest and rents. The major

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5 See Code § 7852(d)(1).

6 § 7852(d)(2).

7 *Ermenegildo Cesarini v. U.S.*, 69-1 USTC ¶9270, 23 AFTR 2d 69-997, 296 F Supp 3 (DC-OH, 1969).

purpose of the regulations is to interpret, explain, clarify and elaborate on the various provisions of the Internal Revenue Code.

Code § 7805(a) authorizes the Secretary of the Treasury to "prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary of any alteration of law in relation to internal revenue." Section 7805(b) provides authority to the Secretary to prescribe the extent, if any, to which any ruling or regulation relating to the internal revenue laws will be applied without retroactive effect. In most cases the Secretary delegates the power to write the regulations to the Commissioner of the Internal Revenue Service. In practice, this means that the regulations are written by the technical staff of the IRS or by the office of the Chief Counsel of the IRS, an official who is also an assistant General Counsel of the Treasury Department.

Regulations are issued in the form of *Treasury Decisions* (often referred to as TDs), which are published in the *Federal Register* and sometimes later in the *Internal Revenue Bulletin*. The *Federal Register* is the official publication for regulations and legal notices issued by the executive branch of the Federal government. The *Federal Register* is published every business day. Before a TD is published in final form, it must be issued in proposed form, a *proposed regulation*, for a period of at least 30 days before it is scheduled to become final.

Upon publication, interested parties have at least 30 days to comment on proposed regulations. In addition, public hearings are often scheduled. In theory, at the end of this comment period, the Treasury responds in any one of three ways; it may withdraw the proposed regulation, amend it, or leave it unchanged. In the latter two cases, the Treasury normally issues the regulation in its final form as a TD, published in the *Federal Register*. The final version of any given regulation is quite frequently significantly different from the proposed version.

Afterwards, the new regulation is included in Title 26 of the *Code of Federal Regulations*. In fact, however, proposed regulations sometimes remain in proposed form for many years. Proposed regulations do not have the force of law and are not the Treasury's official position on a particular issue.

Temporary Regulations. The National Office of the Treasury issues temporary regulations as the need arises. Often such regulations are issued in response to substantive changes in the tax law when tax practitioners, in particular, need immediate guidance in applying a new or revised statute. Such regulations usually deal with immediate filing requirements or details regarding a mandated accounting method change. Temporary regulations are effective immediately without the comment period. This is true even though temporary regulations normally are also issued as proposed regulations which are subject to the comment period. Temporary regulations expire three years after issuance and are given the same respect and precedential value as final regulations.

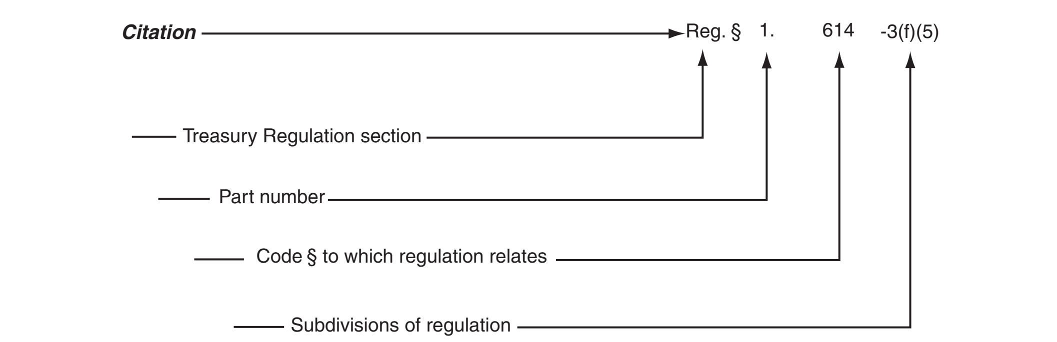
The primary purpose of the regulations is to explain and interpret particular Code sections. Although regulations have not been issued for all Code sections, they have been issued for the great majority. In those cases where regulations exist, they are an important authoritative source on which one can usually rely. Regulations can be classified into three groups: (1) legislative; (2) interpretive; and (3) procedural.

Legislative Regulations. Occasionally, Congress will give specific authorization to the Secretary of the Treasury to issue regulations on a particular Code section. For example, under § 1502, the Secretary is charged with prescribing the regulations for the filing of a consolidated return by an affiliated group of corporations. There are virtually no Code sections governing consolidated returns, and the regulations in effect serve in lieu of the Code. In this case and others where it occurs, the regulation has the force and effect of a law, with the result that a court reviewing the regulation usually will not substitute its judgment for that of the Treasury Department unless the Treasury has clearly abused its discretion.[8]

Interpretative Regulations. Interpretative regulations explain the meaning of a Code section and commit the Treasury and the Internal Revenue Service to a particular position relative to the Code section in question. This type of regulation is binding on the IRS but not on the courts, although it is "a body of experience and informed judgment to which courts and litigants may properly resort for guidance."[9] Interpretive regulations have considerable authority and normally are invalidated only if they are inconsistent with the Code or are unreasonable.

Procedural Regulations. Procedural regulations cover such areas as the information a taxpayer must supply to the IRS and the internal management and conduct of the IRS in certain matters. Those regulations affecting vital interests of the taxpayers are generally binding on the IRS, and those regulations stating the taxpayer's obligation to file particular forms or other types of information are given the effect of law.

Citation for Regulations. Regulations are arranged in the same sequence as the Code sections they interpret. Thus, a regulation begins with a number that designates the type of tax or administrative, definitional, or procedural matter and is followed by the applicable Code section number. For example, Treasury Regulation Section 1.614-3(f)(5) serves as an illustration of how regulations are cited throughout this text.



The part number of a Treasury regulation is used to identify the general area covered by the regulation as follows:

Part Number	*Law Subject*
1	Income Tax
20	Estate Tax
25	Gift Tax
31	Employment Tax
48–49	Excise Tax
301	Procedural Matters

The various subdivisions of a regulation are not necessarily related to a specific subdivision of the Code.

8 *Anderson, Clayton & Co. v. U.S.*, 77-2 USTC ¶9727, 40 AFTR2d 77-6102, 562 F.2d 972 (CA-5, 1977), Cert. den. at 436 U.S. 944 (USSC, 1978).

9 *Skidmore v. Swift and Co.*, 323 U.S. 134 (USSC, 1944).

Sometimes the Treasury issues temporary regulations when it is necessary to meet a compelling need. For example, temporary regulations are often issued shortly after enactment of a major change in the tax law. These temporary regulations have the same binding effect as final regulations until they are withdrawn or replaced. Such regulations are cited as Temp. Reg. §.

Temporary regulations should not be confused with proposed regulations. The latter have no force or effect.[10] Nevertheless, proposed regulations provide insight into how the IRS currently interprets a particular Code section. For this reason, they should not be ignored.

REVENUE RULINGS

Revenue rulings also are official interpretations of the Federal tax laws and are issued by the National Office of the IRS. Revenue rulings do not have quite the authority of regulations, however. Regulations are a direct extension of the law-making powers of Congress, whereas revenue rulings are an application of the administrative powers of the Internal Revenue Service. In contrast to rulings, regulations are usually issued only after public hearings and must be approved by the Secretary of the Treasury.

Unlike regulations, revenue rulings are limited to a given set of facts. For example, in Rev. Rul. 97-9, the IRS addressed whether the provision that concerns medical expenses, § 213, allowed a deduction for the costs of controlled substances such as marijuana when used for medical care. The ruling evaluated § 213 as it applied to this specific set of facts and held that because such purchases were in violation of Federal law they were not deductible.

Taxpayers may rely on revenue rulings in determining the tax consequences of their transactions; however, taxpayers must determine for themselves if the facts of their cases are substantially the same as those set forth in the revenue ruling.

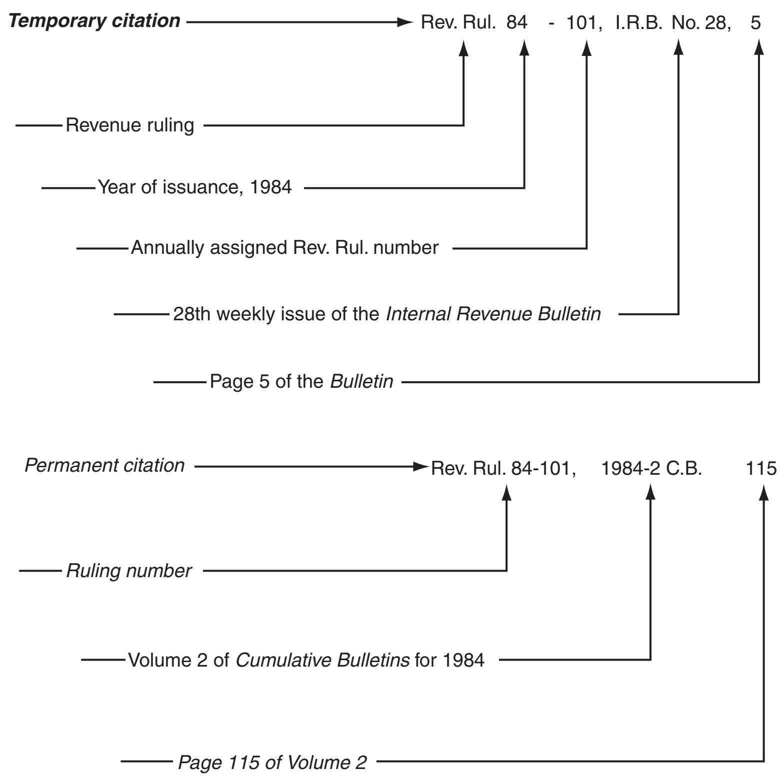
Revenue rulings are published in the weekly issues of the *Internal Revenue Bulletin*. The information contained in the *Internal Revenue Bulletins* (including, among other things, revenue rulings) is accumulated and usually published semiannually in the *Cumulative Bulletin*. The *Cumulative Bulletin* reorganizes the material according to Code section. Citations for the *Internal Revenue Bulletin* and the *Cumulative Bulletin* are illustrated below.

REVENUE PROCEDURES

Revenue procedures are statements reflecting the internal management practices of the IRS that affect the rights and duties of taxpayers. Occasionally they are also used to announce procedures to guide individuals in dealing with the IRS or to make public something the IRS believes should be brought to the attention of taxpayers. For example, each year the IRS announces the rate at which business mileage can be deducted (e.g., Rev. Proc. 2007-70 provides that the rate for 2008 is 50.5 cents per mile).

Revenue procedures are published in the weekly *Internal Revenue Bulletins* and bound in the *Cumulative Bulletin* along with revenue rulings issued in the same year. The citation system for revenue procedures is the same as for revenue rulings except that the prefix "Rev. Proc." is substituted for "Rev. Rul."

[10] Federal law (i.e., the Administrative Procedure Act) requires any federal agency, including the Internal Revenue Service, that wishes to adopt a substantive rule to publish the rule in proposed form in order to give interested persons an opportunity to comment. Proposed regulations are issued in compliance with this directive.



LETTER RULINGS

The term *letter ruling* actually encompasses three different types of rulings: private letter rulings, determination letters, and technical advice memoranda. These items are not published in an official government publication but are available from commercial sources.

Private Letter Ruling. Taxpayers who are in doubt about the tax consequences of a contemplated transaction can ask the National Office of the IRS for a ruling. Generally, the IRS has discretion about whether to rule or not, and it has issued guidelines describing the circumstances under which it will rule.[11]

Unlike revenue rulings, private letter rulings apply only to the particular taxpayer asking for the ruling and are thus not applicable to taxpayers in general. Section 6110(j)(3) specifically states that "unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as a precedent." Recently, however, the IRS has expanded the list of authorities constituting "substantial" authority for Section 6662 purposes to include private letter rulings. As discussed in the previous section, § 6662 imposes an accuracy-related penalty equal to 20 percent of the underpayment unless the taxpayer can cite "substantial authority" for his or her position.

For those requesting a ruling, the IRS's response might provide insurance against surprises. As a practical matter, a favorable ruling should preclude any controversies with the IRS on an audit of that transaction, at least with respect to the matters addressed in the private letter ruling. During the process of obtaining a private letter

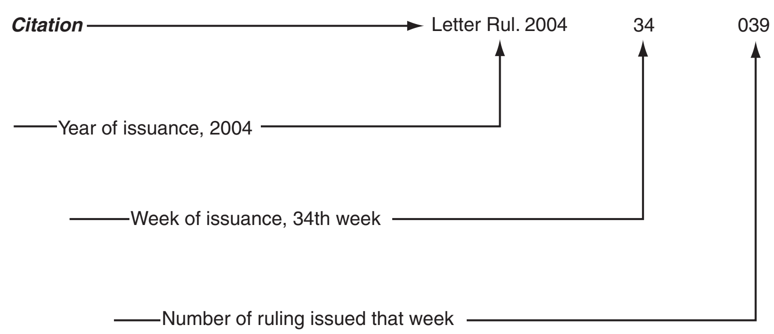
[11] See Rev. Proc. 2007-1, I.R.B. 2007-1 (Appendix D), for a description of the areas in which the IRS has refused to issue advanced rulings. Note, also, that the IRS is required to charge taxpayers a fee for letter rulings, opinion letters, determination letters, and similar requests. The fees range from $50 to $1,000. See § 6591.

ruling, the IRS often recommends changes in a proposed transaction to assist the taxpayer in achieving the tax result he or she wishes. Since 1976, the IRS has made individual private letter rulings publicly available after deleting names and other information that would tend to identify the taxpayer. Private letter rulings are published by both CCH and RIA.

Determination Letter. A determination letter is similar to a private letter ruling, except that it is issued by the office of the local IRS district director, rather than by the National Office. Unlike private letter rulings, determination letters usually relate to completed transactions. Like private letter rulings, they are not published in any official government publication but are available commercially. In most instances, determination letters deal with issues and transactions that are not overtly controversial. Obtaining a determination letter in order to ensure that a pension plan is qualified is a typical use of a determination letter.

Technical Advice Memorandum. A technical advice memorandum ("tech advice") is typically requested by an IRS agent during an audit. The request is normally made to the National Office when the agent has a question that cannot be answered by sources in his or her local office. The technical advice memorandum only applies to the taxpayer for whose audit the technical advice was requested and cannot be relied upon by other taxpayers. Technical advice memoranda are available from private publishers but are not published by the government.

Citations for letter rulings and technical advice follow a multi-digit file number system. IRS Letter Ruling 200434039 serves as an example.



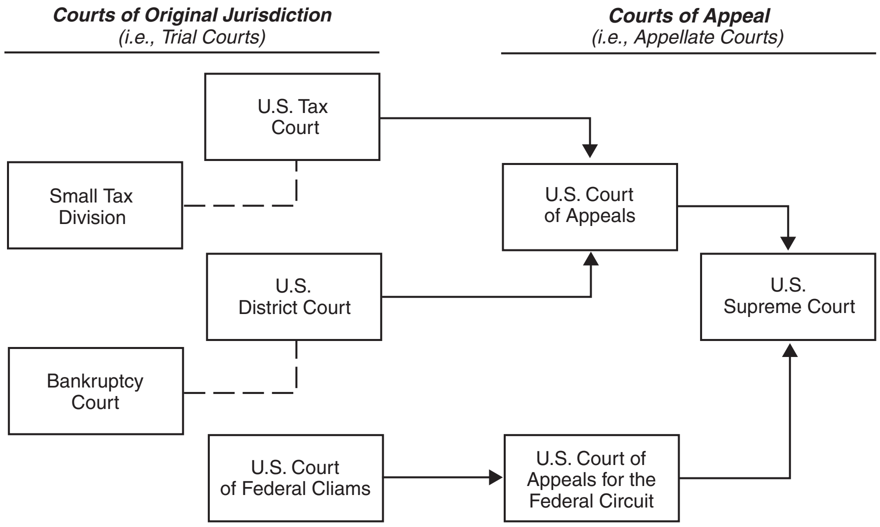
JUDICIAL INTERPRETATIONS

The Congress passes the tax law and the Executive branch of the Federal government enforces and interprets it, but under the American system of checks and balances, it is the Judiciary branch that ultimately determines whether the Executive branch's interpretation is correct. This provides yet another source of tax law—court decisions. It is therefore absolutely essential for the student of tax as well as the tax practitioner to have a grasp of the judicial system of the United States and how tax cases move through this system.

Before litigating a case in court, the taxpayer must have exhausted the administrative remedies available to him or her within the Internal Revenue Service. If the taxpayer has not exhausted his or her administrative remedies, a court will deny a hearing because the claim filed in the court is premature.

All litigation begins in what are referred to as *courts of original jurisdiction*, or *trial courts*, which "try" the case. There are three trial courts: (1) the Tax Court;

(2) the U.S. District Court; and (3) the U.S. Court of Federal Claims. Note that the taxpayer may select any one (and only one) of these three courts to hear the case. If the taxpayer or government disagrees with the decision by the trial court, it has the right to appeal to either the U.S. Court of Appeals or the U.S. Court of Appeals for the Federal Circuit, whichever is appropriate in the particular case. If a litigating party is dissatisfied with the decision by the appellate court, it may ask for review by the Supreme Court, but this is rarely granted. The judicial system is illustrated and discussed on the following page.



TRIAL COURTS

U.S. Tax Court. The Tax Court, as its name suggests, specializes in tax matters and hears no other types of cases. The judges on the court are especially skilled in taxation. Usually, prior to being selected as a judge by the President, the individual was a practitioner or IRS official who was noted for his or her expertise. This Court is composed of 19 judges who "ride circuit" throughout the United States (i.e., they travel and hear cases in various parts of the country as can be seen in the map contained in Exhibit 2-3). Occasionally, the full Tax Court hears a case, but most cases are heard by a single judge who submits his or her opinion to the chief judge, who then decides whether the full court should review the decision.

Besides its expertise in tax matters, two other characteristics of the Tax Court should be noted. Perhaps the most important feature of the Tax Court is that the taxpayer does not pay the alleged tax deficiency before bringing his or her action before the court. The second facet of the Tax Court that bears mentioning is that a trial by jury is not available.

U.S. District Courts. For purposes of the Federal judicial system, the United States is divided into 11 geographic areas called circuits, which are subdivided into districts. For example, the second circuit, which is composed of Vermont, Connecticut, and New York, contains the District Court for the Southern District of New York, which covers parts of New York City. Other districts may include very large areas, such as the District Court for the State of Arizona, which covers the entire state. A taxpayer may take a case into the District Court for the district in which he or she resides, but only after the disputed tax deficiency has been paid. The taxpayer then sues the IRS for a refund of the disputed amount. The District Court is a court of general jurisdiction and hears many types of cases in addition to tax cases. This is the only court in which the taxpayer may obtain a jury trial. The jury decides matters of fact but not matters of law. However, even in issues of fact, the judge may, and occasionally does, disregard the jury's decision.

U.S. Court of Federal Claims. The United States Court of Federal Claims hears cases involving certain claims against the Federal government, including tax refunds. The Court is made up of 16 judges and usually meets in Washington, D.C. A taxpayer must pay the disputed tax deficiency before bringing an action in this court, and may not obtain a jury trial. Appeals from the U.S. Court of Federal Claims are taken to the U.S. Court of Appeals for the Federal Circuit.

The chart below illustrates the position of the taxpayer in bringing an action in these courts.

Small Claims Cases. When the amount of a tax assessment is relatively small, the taxpayer may elect to submit the case to the division of the Tax Court hearing small claims cases, called the Small Tax Division of the Tax Court. If the amount of tax at issue is $50,000 per year or less, the taxpayer can obtain a decision with a minimum of formality, delay, and expense; but the taxpayer loses the right to appeal the decision. The Small Tax Division is administered by the chief judge of the Tax Court, who is authorized to assign small claims cases to special trial judges. These cases receive priority on the trial calendars, and relatively informal rules are followed whenever possible. The special trial judges' opinions are published on these cases, but the decisions are not reviewed by any other court or treated as precedents in any other case.

Bankruptcy Court. Under limited circumstances, it is possible for the bankruptcy court to have jurisdiction over tax matters. The filing of a bankruptcy petition prevents creditors, including the IRS, from taking action against a taxpayer, including the filing of a proceeding before the Tax Court if a notice of deficiency is sent after the filing of a petition in bankruptcy. In such cases, a tax claim may be determined by the bankruptcy court.

	U.S. Tax Court	U.S. District Court	U.S. Court of Federal Claims
Jurisdiction	Nationwide	Specific district in which court is sitting	Nationwide
Subject Matter	Tax cases only	Many different types of cases, both criminal and civil	Claims against the Federal government, including tax refunds
Payment of Contested Amount	Taxpayer does not pay deficiency, but files suit against IRS Commissioner to stop collection of tax	Taxpayer pays alleged deficiency and then files suit against the U.S. government for refund	Taxpayer pays alleged deficiency and then files suit against the U.S. government for refund
Availability of Jury Trial	No	Yes	No
Appeal Taken to	U.S. Court of Appeals	U.S. Court of Appeals	U.S. Court of Appeals for the Federal Circuit
Number of Courts	1	95	1
Number of Judges per Court	19	1	16

APPELLATE COURTS

U.S. Courts of Appeals. Which appellate court is appropriate depends on which trial court hears the case. Taxpayer or government appeals from the District Courts and the Tax Court are taken to the U.S. Court of Appeals that has jurisdiction over the court in which the taxpayer lives. Appeals from the U.S. Court of Federal Claims are taken to the U.S. Court of Appeals for the Federal Circuit, which has the same powers and jurisdictions as any of the other Courts of Appeals except that it only hears specialized appeals. Courts of Appeals are national courts of appellate jurisdiction. With the exceptions of the Court of Appeals for the Federal Circuit and the Court of Appeals for the District of Columbia, these appellate courts are assigned various geographic areas of jurisdiction as shown in the map in Exhibit 2-3 and in the table below.

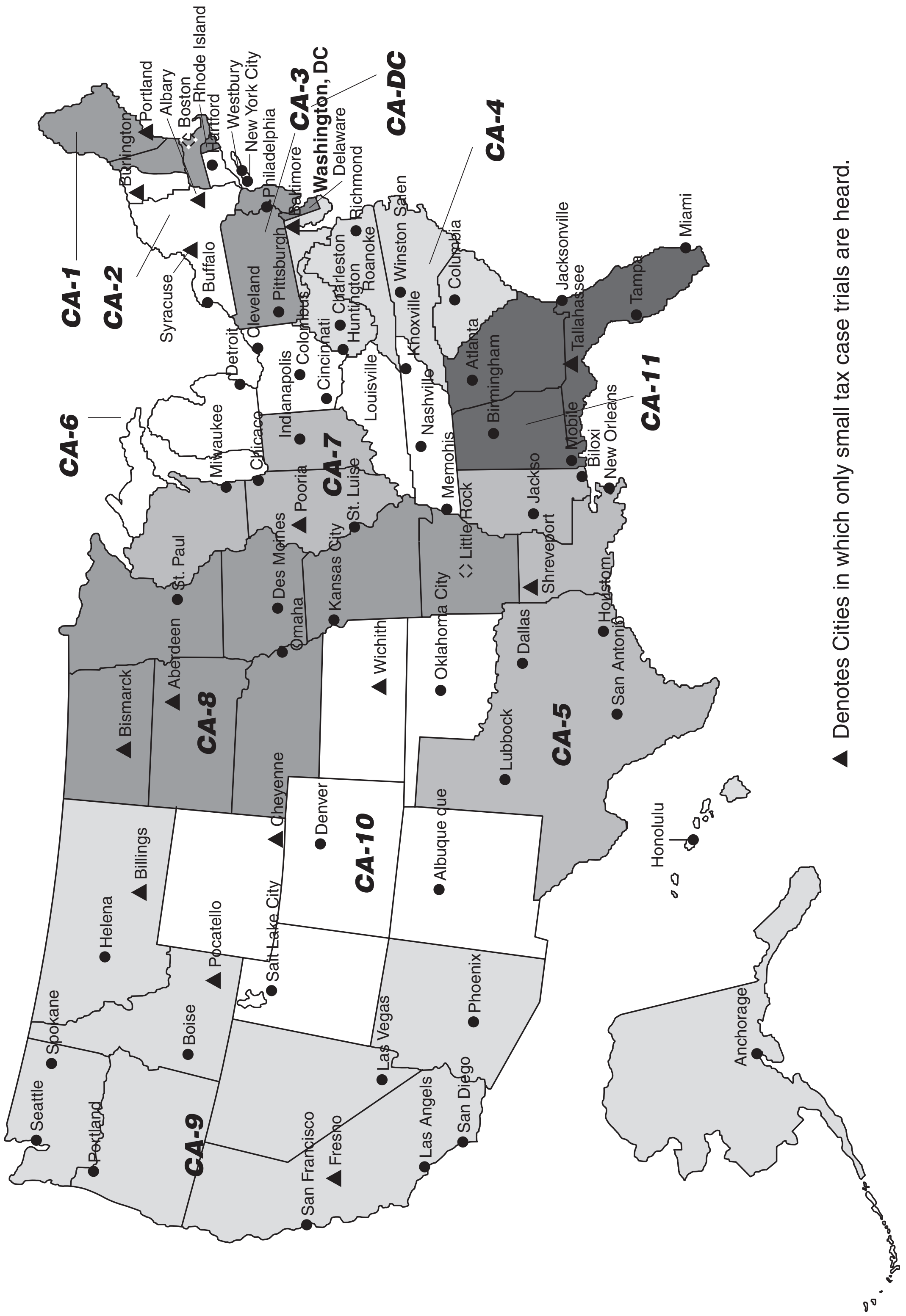
Court of Appeals for the Federal Circuit (CA-FC)	*District of Columbia Circuit (CA-DC)*	*First Circuit (CA-1)*
U.S. Court of Federal Claims	District of Columbia	Maine
		Massachusetts
		New Hampshire
		Puerto Rico
		Rhode Island

Second Circuit (CA-2)	*Third Circuit (CA-3)*	*Fourth Circuit (CA-4)*	*Fifth Circuit (CA-5)*	*Sixth Circuit (CA-6)*
Connecticut	Delaware	Maryland	Louisiana	Kentucky
New York	New Jersey	N. Carolina	Mississippi	Michigan
Vermont	Pennsylvania	S. Carolina	Texas	Ohio
	Virgin Islands	Virginia		Tennessee
		W. Virginia		

Seventh Circuit (CA-7)	*Eighth Circuit (CA-8)*	*Ninth Circuit (CA-9)*	*Tenth Circuit (CA-10)*	*Eleventh Circuit (CA-11)*
Illinois	Arkansas	Alaska	Colorado	Alabama
Indiana	Iowa	Arizona	New Mexico	Florida
Wisconsin	Minnesota	California	Kansas	Georgia
	Missouri	Guam	Oklahoma	
	Nebraska	Hawaii	Utah	
	N. Dakota	Idaho	Wyoming	
	S. Dakota	Montana		
		Nevada		
		Oregon		
		Washington		

EXHIBIT 2-3

United State Tax Court: Places of Trial and U.S. Courts of Appeals



Taxpayers may appeal to the Courts of Appeal as a matter of right, and the Courts must hear their cases. Very often, however, the expense of such an appeal deters many from proceeding with an appeal. Appellate courts review the record of the trial court to determine whether the lower court completed its responsibility of fact finding and applied the proper law in arriving at its decision.

District Courts must follow the decision of the Appeals Court for the circuit in which they are located. For instance, the District Court in the Eastern District of Missouri must follow the decision of the Eighth Circuit Court of Appeals because Missouri is in the Eighth Circuit. If the Eighth Circuit has not rendered a decision on the particular issue involved, then the District Court may make its own decision or follow the decision in another Circuit.

The Tax Court is a national court with jurisdiction throughout the entire country. Prior to 1970, the Tax Court considered itself independent and indicated that it would not be bound by the decisions of the Circuit Court to which its decision would be appealed. In *Golsen*,[12] however, the Tax Court reversed its position. Under the *Golsen rule*, the Tax Court now follows the decisions of the Circuit Court to which a particular case would be appealed. Even if the Tax Court disagrees with a Circuit Court's view, it will decide based upon the Circuit Court's view. On the other hand, if a similar case arises in the jurisdiction of another Circuit Court that has not yet ruled on the same issue, the Tax Court will follow its own view, despite its earlier decision following a contrary Circuit Court decision.

The U.S. Courts of Appeals generally sit in panels of three judges, although the entire court may sit in particularly important cases. They may reach a decision that affirms the lower court or that reverses the lower court. Additionally, the Appellate Court could send the case back to the lower court (remand the case) for another trial or for rehearing on another point not previously covered. It is possible for the Appellate Court to affirm the decision of the lower court on one particular issue and reverse it on another.

Generally, only one judge writes a decision for the Appeals Court, although in some cases no decision is written and an order is simply made. Such an order might hold that the lower court is sustained, or that the lower court's decision is reversed as being inconsistent with one of the Appellate Court's decisions. Sometimes other judges (besides the one assigned to write the opinion) will write additional opinions agreeing with (concurring opinion) or disagreeing with (dissenting opinion) the majority opinion. These opinions often contain valuable insights into the law controlling the case, and often set the ground for a change in the court's opinion at a later date.

U.S. Supreme Court. The U.S. Supreme Court is the highest court of the land. No one has a *right* to be heard by this Court. It only accepts cases it wishes to hear, and generally those involve issues that the Court feels are of national importance. The Supreme Court generally hears very few tax cases. Consequently, taxpayers desiring a review of their trial court decision find it solely at the Court of Appeals. Technically, cases are submitted to the Supreme Court through a request process known as the "Writ of Certiorari." If the Supreme Court decides to hear the case, it grants the Writ of Certiorari; if it decides not to hear the case, it denies the Writ of Certiorari. It is important to note that there is another path to review by the U.S. Supreme Court—*by appeal*—as opposed to by Writ of Certiorari. This "review by appeal" may be available when a U.S. Court of Appeals has held that a state statute is in conflict with the laws or treaties of the United States. The "review by appeal" may also be available when the highest court in a state has decided a case on grounds that a Federal statute or treaty is invalid, or when the state court has held a state statute valid despite the claim of the

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12 *Jack E. Golsen*. 54 T.C. 742 (1970).

losing party that the statute is in conflict with the U.S. Constitution or a Federal law. Review by the U.S. Supreme Court is still discretionary, but a Writ of Certiorari is not involved.

The Supreme Court, like the Courts of Appeals, does not conduct another trial. Its responsibility is to review the record and determine whether or not the trial court correctly applied the law in deciding the case. The Supreme Court also reviews the decision of the Court of Appeals to determine if the court used the correct reasoning.

In general, the Supreme Court hears cases only when one or more of the following conditions apply:

1. When the Court of Appeals has not used accepted or usual methods of judicial procedure or has sanctioned an unusual method by the trial court;

2. When a Court of Appeals has settled an important question of Federal law and the Supreme Court feels such an important question should have one more review by the most prestigious court of the nation;

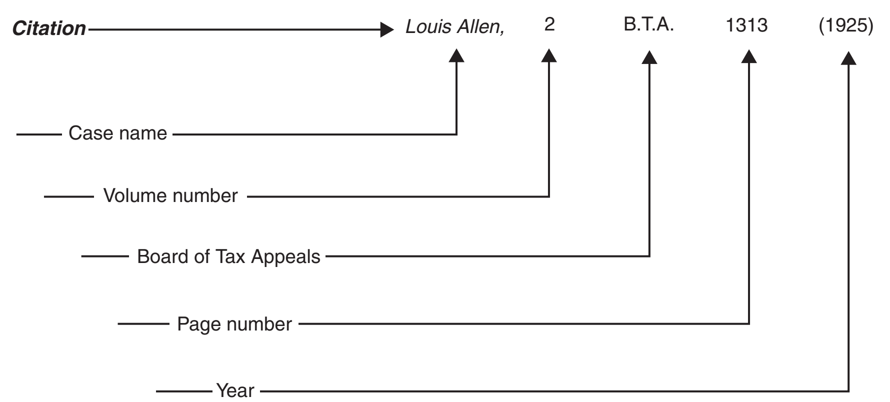
3. When a decision of a Court of Appeals is in apparent conflict with a decision of the Supreme Court;

4. When two or more Courts of Appeals are in conflict on an issue; or

5. When the Supreme Court has already decided an issue but feels that the issue should be looked at again, possibly to reverse its previous decision.

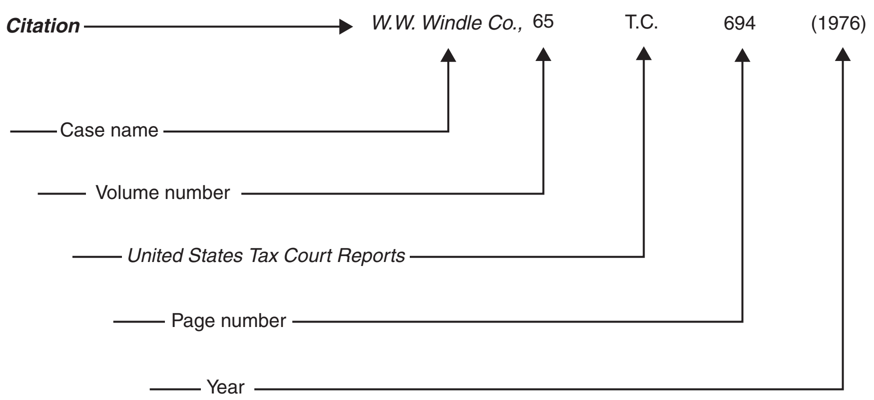
CASE CITATION

Tax Court Decisions. Prior to 1943, the Tax Court was called the Board of Tax Appeals. The decisions of the Board of Tax Appeals were published as the *United States Board of Tax Appeals Reports* (BTA). Board of Tax Appeals cases are cited as follows:



The Tax Court renders two different types of decisions with two different citation systems: Regular decisions and Memorandum decisions.

Tax Court *Regular* decisions deal with new issues that the court has not yet resolved. In contrast, decisions that deal only with the application of already established principles of law are called *Memorandum* decisions. The United States government publishes Regular decisions in *United States Tax Court Reports* (T.C.). Tax Court Regular decisions are cited as follows:



Like revenue rulings and the *Cumulative Bulletins*, there is a time lag between the date a Tax Court Regular decision is issued and the date it is bound in a *U.S. Tax Court Report* volume. In this case, the citation appears as follows:

Temporary Citation:

W.W. Windle Co., 65 T.C. ________, No. 79(1976).

Here the page is left out, but the citation tells the reader that this is the 79th Regular decision issued by the Tax Court since Volume 64 ended. When the new volume (65th) of the Tax Court Report is issued, then the permanent citation may be substituted for the old one. Both CCH and RIA have tax services that allow the researcher to find these temporary citations.

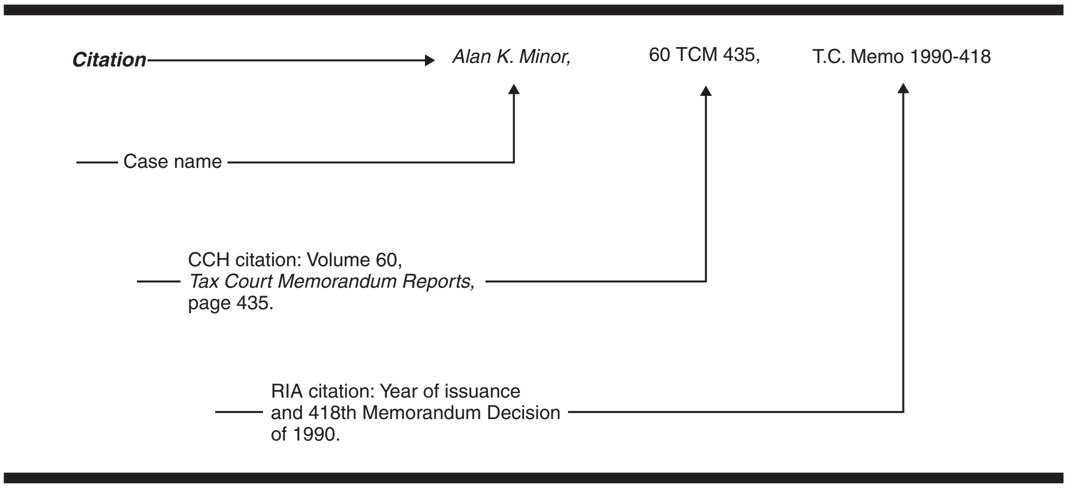
The IRS has adopted the practice of announcing whether it agrees or disagrees with a decision issued by a court by announcing its acquiescence or nonacquiescence. Until 1991, this practice was limited to certain Regular decisions of the Tax Court. At that time, however, the IRS began to acquiesce or nonacquiesce to other cases where it thought it would be useful.[13] The IRS may withdraw its acquiescence or nonacquiescence at any time and may do so even retroactively. Acquiescences and nonacquiescences are published in the weekly *Internal Revenue Bulletins* and the *Cumulative Bulletins*.

The U.S. government publishes the Tax Court's Regular decisions, and also posts the decisions to its website (http://www.ustaxcourt.gov). The website currently has both Regular and Memorandum decisions since September 25, 1995. The Tax Court does not publish memorandum decisions. However, both CCH and RIA publish them. CCH publishes the memorandum decisions under the title *Tax Court Memorandum Decisions* (TCM), while RIA publishes these decisions as *Tax Court Reporter and Memorandum Decisions* (T.C. Memo). In citing Tax Court memorandum decisions, some authors prefer to use both the RIA and the CCH citations for their cases.

Beginning in 2001, decisions of the Small Claims division of the Tax Court are published on the U.S. Tax Court Web site as U.S. Tax Court Summary Opinions, with the caveat that such cases may not be treated as precedent for any other case.

In an effort to provide the reader the greatest latitude of research sources, this dual citation policy has been adopted for this text. The case of *Alan K. Minor* serves as an example of the dual citation of Tax Court memorandum decisions.

[13] The IRS's acquiescence is symbolized by "A" or "Acq." and its nonacquiescence by "NA" or "Nonacq."



As noted above, Tax Court Summary Opinions can be found at the website of the Tax Court or through RIA and CCH. All use the same form of citation. For example, the decision in Richard Bradley on January 21, 2006 would be cited as follows:

Richard Bradley, T.C. Summary Opinion, 2006–61

Citations for U.S. District Court, Court of Appeals, and Claims Court. Commerce Clearing House, Research Institute of America, and West Publishing Company all publish decisions of the District Courts, Courts of Appeals, and the Court of Federal Claims. When available, all three citations of a case are provided in this text.[14] CCH publishes the decisions of these courts in its *U.S. Tax Cases* (USTC—not to be confused with the *U.S. Tax Court Reports*) volumes, and RIA offers these decisions in its *American Federal Tax Reports* (AFTR) series.[15] West Publishing Company reports these decisions in either its *Federal Supplement Series* (F. Supp.—District Court decisions), or its *Federal Second Series or Federal Third Series* (F.2d or F.3d—Court of Federal Claims and Courts of Appeals decisions).

The citation of the U.S. District Court decision of *Cam F. Dowell, Jr. v. U.S.* is illustrated for each of the three publishing companies as follows:

CCH Citation:

Cam F. Dowell, Jr. v. U.S., 74-1 USTC ¶9243, (D.Ct. Tx., 1974).

Interpretation: This case is reported in the first volume of the *U.S. Tax Cases*, published by CCH for calendar year 1974 (74-1), located at paragraph (¶) 9243, and is a decision rendered in 1974 by a U.S. District Court located in Texas (Tx.).

RIA Citation:

Cam F. Dowell, Jr. v. U.S., 33 AFTR2d 74-739, (D.Ct. Tx., 1974).

Interpretation: Reported in the 33rd volume of the second series of the *American Federal Tax Reports* (AFTR2d), published by RIA for 1974, and located at page 739.

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[14] When all three publishers have not printed the case, only the citations to the cases published are provided.

[15] Until the acquisition of Prentice Hall by RIA, Prentice Hall published cases under its own name. Accordingly, researchers needing cases from before 1993 will often encounter Prentice Hall as publisher of these reporters now carried under RIA's name.

West Citation:

Cam F. Dowell, Jr. v. U.S., 370 F.Supp. 69 (D.Ct. Tx., 1974).

Interpretation: Located in the 370th volume of the *Federal Supplement Series* (F.Supp), published by West Publishing Company, and located at page 69.

The multiple citation of the U.S. District Court case illustrated above appears as follows:

Cam F. Dowell, Jr. v. U.S., 74-1 USTC ¶9243, 33 AFTR2d 74-739, 370 F.Supp. 69 (D.Ct. Tx., 1974).

Decisions of the Court of Federal Claims (Ct. Cls.), the Courts of Appeals (e.g., CA-1, CA-2, etc.), and the Supreme Court (USSC) are published by CCH and RIA in the same reporting source as District Court decisions (i.e., USTCs and AFTRs). Court of Federal Claims and Court of Appeals decisions are reported by West Publishing Company in its *Federal Second Series* (F.2d) or *Federal Third Series* (F.3d). West also publishes the *Federal Appendix* (Fed. Appx.) which includes opinions not selected by the Courts of Appeals for publication in the Federal reporters. Supreme Court decisions are published by West Publishing Company in its *Supreme Court Reports* (S.Ct.), and the U.S. Government Printing Office publishes Supreme Court decisions in its *Supreme Court Reports* (U.S.).

An example of the multiple citation of a Court of Appeals decision follows:

Citation:

Millar v. Comm., 78-2 USTC ¶9514, 42 AFTR2d 78-5246, 577 F.2d 212 (CA-3, 1978).

A multiple citation of a Supreme Court decision would appear as follows:

Citation:

Fausner v. Comm., 73-2 USTC ¶9515, 32 AFTR2d 73-5202, 413 U.S. 838 (USSC, 1973).

Note that in each of the citations above, the designation "Commissioner of the Internal Revenue Service" is simply abbreviated to "Comm." In some instances, the IRS or U.S. is substituted for Comm., and older cases used the Commissioner's name. For example, in *Gregory v. Helvering*, 293 U.S. 465 (USSC, 1935), Mr. Helvering was the Commissioner of the Internal Revenue Service at the time the case was brought to the Court. Also note that the citation contains a reference to the Appellate Court rendering the decision (i.e., CA-3, or USSC) and the year of issuance.

Exhibits 2-4 and 2-5 summarize the sources of case citations from various reporter services.

EXHIBIT 2-4
Reporters of Tax Court Decisions

Reporter	*Abbr.*	*Type*	*Publisher*
Tax Court Reports	TC	Regular	Government Printing Office
Tax Court Memorandum Decisions	TCM	Memorandum	Commerce Clearing House
Tax Court Memorandum Decisions	TC Memo	Memorandum	Research Institute of America

EXHIBIT 2-5
Reporters of Decisions Other Than Tax Court

Reporter	*Abbr.*	*Courts Reported*	*Publisher*
Supreme Court Reports	U.S.	Supreme Court	Government Printing Office
Supreme Court Reporter	S.Ct	Supreme Court	West Publishing
Federal Supplement	F.Supp	District Courts	West Publishing
Federal Reporter	F. F.2d F.3d	Cts. of Appeals and Ct. of Fed. Cls.	West Publishing
Federal Appendix	Fed. Appx.	Cts. of Appeals Unreported cases	West Publishing
American Federal Tax Reports	AFTR2d	Ct. of Fed. Cls. Cts. of Appeals, and Supreme Ct.	Research Institute of America
United States Tax Cases	USTC	Same as AFTR and AFTR2d	Commerce Clearing House

SECONDARY SOURCES

The importance of understanding the sources discussed thus far stems from their role in the taxation process. As mentioned earlier, the statutory law and its official interpretations constitute the legal authorities that set forth the tax consequences for a particular set of facts. These legal authorities, sometimes referred to as *primary authorities*, must be distinguished from so-called *secondary sources* or *secondary authorities*. The secondary sources of tax information consist mainly of books, periodicals, articles, newsletters, and editorial judgments in tax services. When working with the tax law, it must be recognized that secondary sources are unofficial interpretations—mere opinions—that have no legal authority.

Although secondary sources should not be used as the supporting authority for a particular tax treatment (except as a supplement to primary authority or in cases where primary authority is absent), they are an indispensable aid when seeking an understanding of the tax law. Several of these secondary materials are discussed briefly below.

TAX SERVICES

"Tax service" is the name given to a set of organized materials that contains a vast quantity of tax-related information organized so as to make it useful and accessible to tax practitioners. In general, a tax service is a paper or electronic compilation of some or all of the following: the Code, regulations, court decisions, IRS releases, and explanations of these primary authorities by the editors. As the listing of contents suggests, a tax service is invaluable since it contains, all in one place, a wealth of tax information, including both primary and secondary sources. Most tax services are available on CD-ROM or the Internet, or both. Moreover, these materials are updated constantly to reflect current developments—an extremely important feature given the dynamic nature of tax law. The major tax services are:

Publisher	*Name of Publications*
Commerce Clearing House	*Standard Federal Tax Reporter—Income Taxes*
Research Institute of America	*United States Tax Reporter and Federal Tax Coordinator—2nd Series*
The Bureau of National Affairs, Inc.	*Tax Management Portfolios—U.S. Income*

The widespread use of computers has found applications in tax research. For example, *LEXIS* is a computerized data base that a user can access through his or her personal computer. The *LEXIS* data base contains almost all information available in an extensive tax library. Suppliers of tax services currently make computer-based tax liabraries available to their customers. Undoubtedly computers are basic to tax research.

Commerce Clearing House, Research Institute of America, and other publishers issue weekly summaries of important cases and other tax developments that many practitioners and scholars find helpful in keeping current with developments in the tax field. The Bureau of National Affairs publishes the *Daily Tax Bulletin*, a comprehensive daily journal of late-breaking tax news that often reprints entire cases or regulations of particular importance. *Tax Notes*, published by Tax Analysts, is a weekly publication addressing legislative and judicial developments in the tax field. *Tax Notes* is particularly helpful in following the progress of tax legislation through the legislative process.

TAX PERIODICALS

In addition to these services, there are a number of quality publications (usually published monthly) that contain articles on a variety of important tax topics. These publications are very helpful when new tax acts are passed, because they often contain clear, concise summaries of the new law in a readable format. In addition, they serve to convey new planning opportunities and relay the latest IRS and judicial developments in many important sub-specialities of the tax profession. Some of the leading periodicals include the following:

ATA Journal of Legal Tax Research
Estate Planning
Journal of Corporate Taxation
Journal of Partnership Taxation
Journal of Real Estate Taxation
Journal of Taxation
Tax Law Journal
Tax Law Review
Taxes—The Tax Magazine
The International Tax Journal
The Review of Taxation of Individuals
The Tax Advisor
The Tax Executive
The Tax Lawyer
Trusts and Estates

In addition to these publications, many law journals contain excellent articles on tax subjects.

Several indexes exist that may be used to locate a journal article. Through the use of a subject index, author index, and in some instances a Code section index, articles dealing with a particular topic may be found. Three of these indexes are:

Title	*Publisher*
Index to Federal Tax Articles	Warren, Gorham and Lamont
Federal Tax Articles	Commerce Clearing House
The Accountant's Index	American Institute of Certified Public Accountants

In addition, the *United States Tax Reporter*, published by RIA, contains a section entitled "Index to Tax Articles."

TAX RESEARCH

Having introduced the sources of tax law, the remainder of this chapter is devoted to working with the law—or more specifically, the art of tax research. Tax research may be defined as the process used to ascertain the optimal answer to a question with tax implications. Although there is no perfect technique for researching a question, the following approach normally is used:

1. Obtain all of the facts
2. Diagnose the problem from the facts
3. Locate the authorities
4. Evaluate the authorities
5. Derive the solution and possible alternative solutions
6. Communicate the answer

Each of these steps is discussed below.

OBTAINING THE FACTS

Before discussing the importance of obtaining all the facts, the distinction between closed fact research and open- or controlled-fact research should be noted. If the research relates to a problem with transactions that are complete, it is referred to as closed-fact research and normally falls within the realm of tax practice known as tax compliance. On the other hand, if the research relates to contemplated transactions, it is called controlled- or open-fact research and is an integral part of tax planning.

In researching a closed-fact problem, the first step is gathering all of the facts. Unfortunately, it is difficult to obtain all relevant facts upon first inquiry. This is true because it is essentially impossible to understand the law so thoroughly that all of the proper questions can be asked before the research task begins. After the general area of the problem is identified and research has begun, it usually becomes apparent that more facts must be obtained before an answer can be derived. Consequently, additional inquiries must be made until all facts necessary for a solution are acquired.

DIAGNOSING THE ISSUE

Once the initial set of facts is gathered, the tax issue or question must be identified. Most tax problems involve very basic questions such as these:

1. Does the taxpayer have gross income that must be recognized?
2. Is the taxpayer entitled to a deduction?
3. Is the taxpayer entitled to a credit?
4. In what period is the gross income, deduction, or credit reported?
5. What amount of gross income, deduction, or credit must be reported?

As research progresses, however, such fundamental questions can be answered only after more specific issues have been resolved.

Example 1. R's employer owns a home in which R lives. The basic question that must be asked is whether use of the home constitutes income to R. After consulting the various tax sources, it can be determined that § 61 requires virtually all benefits to be included in income unless another provision specifically grants an exclusion. In this case, § 119 allows a taxpayer to exclude the value employer-provided of housing if the housing is on the employer's premises, the lodging is furnished for the convenience of the employer, and the employee is required by the employer to accept the housing. Due to the additional research, three more specific questions must be asked:

1. Is the home on the employer's premises?

2. Is the home provided for the employer's convenience?

3. Is R required to live in the home?

As the above example suggests, diagnosing the problem requires a continuing refinement of the questions until the critical issue is identified. The refinement that occurs results from the awareness that is gained through reading and rereading the primary and secondary authorities.

Example 2. Assume the same facts as in *Example 1*. After determining that one of the issues concerns whether R's home is on the business premises, a second inquiry is made of R concerning the location of his residence. (Note that as the research progresses, additional facts must be gathered.) According to R, the house is located in a suburb, 25 miles from his employer's downtown office. However, the house is owned by the employer, and hence R suggests that he lives on the employer's premises. He also explains that he often brings work home and frequently entertains clients in his home. Having uncovered this information, the primary authorities are reexamined. Upon review, it is determined that in *Charles N. Anderson*,[16] the court indicated that an employee would be considered on the business premises if the employee performed a significant portion of his duties at the place of lodging. Again the question must be refined to ask: Do R's work and entertainment activities in the home constitute a significant portion of his duties?

LOCATING THE AUTHORITIES

Identification of the critical issue presented by any tax question begins by first locating, then reading and studying the appropriate authority. Locating the authority is ordinarily done using a tax service. With the issue stated in general terms, the subject is found in the index volume and the location is determined. At this point, the appropriate Code sections, regulations, and editorial commentary may be perused to determine their applicability to the question.

Example 3. In the case of R above, the problem stated in general terms concerns income. Using an index, the key word, *income*, could be located and a reference to information concerning the income aspects of lodging would be given.

Once information relating to the issue is identified, the authoritative materials must be read. That is, the appropriate Code sections, regulations, rulings, and cases must be examined and studied to determine how they relate to the question. As suggested above, this process normally results in refinement of the question, which in turn may require acquisition of additional facts.

16 67-1 USTC ¶9136, 19 AFTR2d 318, 371 F.2d 59 (CA-6, 1966).

EVALUATING THE AUTHORITY

After the various authorities have been identified and it has been *verified* that they are applicable, their value must be appraised. This evaluation process, as will become clear below, primarily involves appraisal of court decisions and revenue rulings.

The Code. The Internal Revenue Code is the final authority on most tax issues since it is the Federal tax law as passed by Congress. Only the courts can offset this authority by declaring part of the law unconstitutional, and this happens rarely. Most of the time, however, the Code itself is only of partial help. It is written in a style that is not always easy to understand, and it contains no examples of its application. Accordingly, to the extent the Code can be understood as clearly applicable, no stronger authority exists, except possibly a treaty. But in most cases, the Code cannot be used without further support.

Treasury Regulations. As previously discussed, the regulations are used to expand and explain the Code. Because Congress has given its authority to make laws to the Executive branch's administrative agency—the Treasury—the regulations that are produced are a very strong source of authority, second only to the Code itself. Normally, the major issue when a regulation is under scrutiny by a Court is whether the regulation is consistent with the Code. If the regulations are inconsistent, the Court will not hesitate to invalidate them.

Judicial Authority. The value of a court decision depends on numerous factors. On appraising a decision, the most crucial determination concerns whether the outcome is consistent with other decisions on the same issue. In other words, consideration must be given to how other decisions have evaluated the one in question. An invaluable tool in determining the validity of a case is a *citator*. A tax citator provides an alphabetical listing by last name of virtually all tax cases and other administrative pronouncements (e.g. rulings). After the name of each case, there is a record of other decisions that have cited (in the text of their facts and opinions) the first case. The list of cases is organized by type of court and then by year. Exhibit 2-4 provides sample entries from the citators published by RIA and CCH for the Supreme Court's decision in *Indianapolis Power and Light Co*.

> **Example 4.** Refer to Exhibit 2-6 and the sample entries from the RIA and CCH citators. Observe that the Supreme Court's decision in *Indianapolis Power and Light Co. (IPL)* was cited (mentioned) in a number of cases at various levels as well in several rulings. For instance, the *IPL* decision was cited by the Supreme Court in *Banks II*, by the Ninth Circuit in *Westpac-Pacific Foods* and by the Tax Court in *Tampa Bay Devil Rays, Ltd*. Similarly, *IPL* was cited in Rev. Proc. 91-31 and Rev. Rul. 2003-39.

It is important to note that tax citators often use abbreviations for subsequent case history. For example, the abbreviations *aff'g* and *aff'd* mean "affirming" and "affirmed" and indicate that an appeals court has upheld the decision in question. Similarly, *rev'g* and *rev'd* mean "reversing" and "reversed" and indicate that a trial court's decision was overturned. Finally, *rem'g* and *rem'd* mean "remanding" and "remanded" and indicate that the case has been sent back to a lower court for reconsideration.

The validity of a particular decision may be assessed by examining how the subsequent cases viewed the cited decision. For example, subsequent cases may have agreed or disagreed with the decision in question, or distinguished the facts of the cited case from those examined in a later case. In this regard, note how the RIA citator provides a notation, indicating the relationship between the cited and citing cases. For example, the Banks II decision is shown as having "cited favorably" the IPL decision. The CCH citator does not provide this information.

EXHIBIT 2-6

Tax Citators: RIA and CCH

RIA Citator
(online; partial list of entries)

Name of cited case

INDIANAPOLIS POWER & LIGHT CO.; COMM v, 65 AFTR 2d 90-394 , 493 US 203 , 110 S Ct 589 , 107 L Ed 2d 591 , 90-1 USTC ¶50,007 (US, 1/9/1990)

Alternative citations for cited case, includes citations from RIA, West and CCH

Judicial History

Affirming earlier case: Indianapolis Power & Light Co. v Comm., 62 AFTR 2d 88-5708 , 857 F2d 1162 (CA7, 9/20/1988)
Affirming earlier case: Indianapolis Power & Light Co., 88 TC 964 , ¶88.52 PH TC (4/20/1987)

Supreme Court decision agreed with decisions made earlier by 7th Circuit and the Tax Court

Cited In

Indicates how citing case (Banks) treated the cited case (IPL)

Cited favorably : Banks, John W., II; Com. v., 95 AFTR 2d 2005-664,125 S Ct 831 (US, 1/24/2005) [See 65 AFTR 2d 90-397, 493 US 209]
Reasoning followed: Ware, R. Timmis v Comm., 66 AFTR 2d 90-5198, 906 F2d 64 (CA2, 6/21/1990) [See 65 AFTR 2d 90-397, 110 S Ct 593-594]
Cited generally: Webb, Frederick L. v I.R.S., 73 AFTR 2d 94-1021, 15 F3d 205 (CA1, 2/3/1994)
Cases distinguished : George, Randolph; U.S. v., 96 AFTR 2d 2005-5821, 420 F3d 996 (CA9, 8/23/2005) [See 65 AFTR 2d 90-397, 493 US 209-210]
Cited favorably : Westpac Pacific Food v. Com., 97 AFTR 2d 2006-3018, 451 F3d 975 (CA9, 6/21/2006) [See 65 AFTR 2d 90-396, 493 US 207]
Cases reconciled : Tampa Bay Devil Rays, Ltd., 2002 RIA TC Memo 2002-1539 [See 65 AFTR 2d 90-495, 90-499, 493 US 204-205, 214]
Reasoning followed 1 : Rev Proc 91-31 , 1991-1 CB 567
Cited generally 1 : Rev Rul 2003-39 , 2003-1 CB 811

Cases and rulings that have cited the Supreme Court's decision in Indianapolis Power and Light Co.

CCH Citator
(online; partial list of entries)

Name of cited case

Indianapolis Power and Light Co.

Locations in CCH where case and issues are discussed

ANNOTATED AT ... 2007FED ¶5504.6992; ¶21,005.027; ¶21,005.035; ¶21,005.7039; ¶21,005.7080; ¶21,017.18

- **SCt**--(aff'g CA), 90-1 USTC ¶50,007; 493 US 203; 110 SCt 589
  Banks II, SCt, 2005-1 USTC ¶50,155, 543 US 426, 125 SCt 826
  Westpac Pacific Foods, CA-9, 2006-2 USTC ¶50,369, 451 F3d 970
  George, CA-9, 2005-2 USTC ¶50,546, 420 F3d 991
  Webb, CA-1, 94-1 USTC ¶50,071, 15 F3d 203
  Ware, CA-2, 90-2 USTC ¶50,342, 906 F2d 62
  Tampa Bay Devil Rays, Ltd., TC, Dec. 54,893(M), 84 TCM 394, TC Memo. 2002-248
  Let. Rul. 200110002, October 4, 2000
  Let. Rul. 200347014, August 4, 2003
  Rev. Proc. 91-31
  Rev. Rul. 2003-39, IRB 2003-17, 811; 2003-1 CB 811

Alternative citations for cited case (IPL)

Cases and rulings that have cited the Supreme Court's decision in Indianapolis Power and Light Co.

Another important factor that must be considered in evaluating a court decision is the level of the court that issued it. Decisions issued by trial courts have less value than those issued by appellate courts. And, of course, decisions of the Supreme Court are the ultimate authority.

A court decision's value rises appreciably if the IRS agrees with its result. As discussed earlier, the IRS usually indicates whether it acquiesces or does not acquiesce to Regular Tax Court decisions. The position of the Service may also be published in a revenue ruling.

Rulings. The significance of revenue rulings lies in the fact that they reflect current IRS policy. Since agents of the IRS are usually reluctant to vary from that policy, revenue rulings carry considerable weight.

Revenue rulings are often evaluated in court decisions. Thus, a tax service should be used to determine whether relevant rulings have been considered in any decisions. By examining the Court's view of the ruling, possible flaws may be discovered.

Private letter rulings issued to the taxpayer must be followed for that taxpayer by the IRS as long as the transaction is carried out in the manner initially approved. Variation from the facts on which the ruling was based permits the Service to revise its position. As mentioned earlier, a private letter ruling applies only to the particular taxpayer to whom it was issued. However, such a ruling should prove helpful to any other taxpayer faced with a substantially identical fact pattern.

DERIVING THE SOLUTION

Once all the relevant authorities have been evaluated, a conclusion must be drawn. Before deriving the final answer or answers, however, an important caveat is warranted: the researcher must ensure that the research reflects all current developments. The new matters section of a tax service can aid in this regard. The new matters section updates the textual discussion with any late-breaking developments. For instance, the section will contain any new cases, regulations, or pronouncements of the Internal Revenue Service that may bear on the discussion of the topic covered in the main text.

COMMUNICATING THE FINDINGS

The final product of the research effort is a memorandum recording the research and a letter to the interested parties. Although many formats are suitable for the memorandum, one technique typically used is structured as follows:

1. Description of the facts
2. Statement of the issues or questions researched
3. Report of the conclusions (brief answers to the research questions)
4. Discussion of the rationale and authorities that support the conclusions
5. Summary of the authorities consulted in the research

A good tax memorandum is essential. If the research findings are not communicated intelligently and effectively, the entire research effort is wasted.

RULES OF TAX PRACTICE: RESPONSIBILITIES AND ETHICS

Over the past several years there has been a great deal of attention focused on ethics in business. The world of taxation has not escaped this attention. Unethical behavior of taxpayers and tax preparers has always been a serious concern of the tax system, primarily because of its reliance on voluntary compliance.

Anyone who has ever filed an income tax return recognizes the potential for bilking the system. It is as easy as underreporting income or overstating deductions. What is perhaps more important is that it can be done with so little risk. The current audit rate is so low—approximately 1 percent—that many dishonest taxpayers think they can exploit the system with little chance that they will ever get caught. That the tax system is such an easy mark was underscored recently in testimony given before the House Ways and Means Oversight Subcommittee by two practitioners convicted of tax fraud for illegal refund schemes. In his testimony, Barry Becht, a 36-year-old former tax return preparer, explained that, before he was convicted and sent to Federal prison, he had "helped" his clients reduce their tax liabilities by over $750,000 simply by overstating their deductions. Surprisingly, Becht did not share in his client's windfalls. Allegedly his only purpose was to build up his practice! The other convicted felon, Frazier Todd, reported that he had gained more than $500,000 in only two years using electronic filing schemes. Shortly after college and with the help of a few courses on computers, accounting, and business, Todd had set up a tax-preparation service near public housing in Atlanta. There he was able to strike deals with low-income taxpayers who allowed him to use their names and social security numbers to falsify wage statements (W-2 forms). He then proceeded to file returns electronically, which enabled him to obtain a refund before the IRS discovered that the returns were phony. Unfortunately, the stories of Becht and Todd are just two illustrations of how easy it is to abuse the system. Near the close of 1993, the IRS estimated that the "tax gap," the amount of unpaid taxes (income, payroll, and excise) due to cheating and fraud, was over $150 billion annually. By 2001, the gap had increased to as much as $353 billion.[17]

The problems of tax fraud do not go unnoticed, however. To safeguard the system, encourage compliance, and promote ethical behavior, the government has adopted a number of mechanisms. Among these is an intricate set of penalties that can be applied to both taxpayers and tax return preparers. These penalties cover a variety of violations, such as failure to file and pay taxes on a timely basis, negligence in preparing the tax return, and outright fraud. While the penalties are usually monetary in nature, criminal penalties—such as the jail sentences given to Mr. Becht and Mr. Todd—may result if the taxpayer goes beyond these civil offenses and purposefully attempts to evade tax. The failure-to-file and failure-to-pay penalties—penalties that typically result not because taxpayers are trying to deceive the government but simply because they are late in filing and paying their taxes—are discussed in Chapter 4. The focus in this chapter is on the responsibilities of taxpayers and tax return preparers in filing returns and the major penalties that may be imposed with respect to positions taken on returns.

TAXPAYER PENALTIES

In a 1985 IRS survey, one out of every five people reported that they cheated on their tax return. In the same survey, 41 percent said they believed that their fellow taxpayers also cheated. Similarly, Professor Peggy Hite found in a 1993 survey of Indiana residents that 40 percent of the individuals asked indicated that they definitely would not voluntarily report prize income, such as money won in a lottery or similar contests and sweepstakes.[18] Another 30 percent were somewhat wishy-washy in their answers, suggesting that, depending on the circumstances, they also would not report the income. But anyone thinking about cheating should recognize that it can be quite expensive. The IRS has over 140 penalties in its arsenal that it could apply. In their simplest form, these penalties provide that as long as taxpayers do not cheat and make a good faith effort to determine their tax liability, they have no reason to worry. But in reality the ethical problems created by the tax system for taxpayers and tax preparers can be difficult to resolve. Unfortunately, the law rarely provides clear-cut answers, leaving taxpayers wondering what they should do.

As an illustration, consider two taxpayers, both with bad backs, who bought $5,000 hot tubs on the hope that they might have some therapeutic value. Can the taxpayers deduct their costs as a medical expense? Even if they researched the question every day of the week for a month, the answer may not be clear. Should the fact that the answer is not clear preclude them from deducting their expenses? Some taxpayers might be inclined to simply abandon the issue, pay the tax and never worry about it again. But others might believe that there is some support for their position and want to take the deduction. So

17 IR News Release 2005-38 (Mar. 29, 2005).

18 "Nearly 1 in 3 Would Cheat on Taxes," *The Indianapolis Star*, April 7, 1994, B1.

assume in this case taxpayer A deducts the expense and taxpayer B deducts not only the cost of the tub but, banking on the audit lottery, also deducts the entire cost of the house on the grounds that it serves as a rehabilitation facility. What happens if both returns are audited and the agent rejects the deductions of both taxpayers? Obviously the system of punishment should fit the crime. And this is what Congress has attempted to do by creating a penalty system that fairly treats taxpayers who in good faith believe that their position has validity but at the same time discourages taxpayers from taking frivolous positions, hoping that the audit lottery will never pick their number.

As the penalty discussion below will reveal, the tax law has its own way of dealing with taxpayers who stray too far from the correct position. While the system is complex, it is somewhat analogous to the way a mother treats her teenage son who is apt to stay out beyond his 12 o'clock curfew. If the son is a few minutes late, there will probably be no penalty if he has a reasonable explanation. On the other hand, if he gets home two hours late, the penalty will probably be severe unless he called to say he would be late. But if he never called, punishment is a virtual certainty unless his story is truly believable and backed by witnesses. And, of course, if her son lies, he will be grounded forever. Although the rules for breaking curfew are not completely analogous to those for taxpayers that take erroneous positions on returns, the comparison may be useful. If a taxpayer takes an incorrect position with respect to a *small* amount, there will be no penalty as long as there is a *reasonable basis* for the position. On the other hand, if the tax dollars involved are *substantial*, a penalty is normally imposed unless the taxpayer has *substantial authority* for the position or, alternatively, has disclosed the position and has a reasonable basis for it. Of course, if the taxpayer commits blatant fraud, the penalties could be quite harsh. These ethical standards for taxpayers are embedded in two types of penalties: accuracy-related penalties and penalties for fraud.

ACCURACY-RELATED PENALTIES

What happens if a waiter simply fails to report all of his tips? What if a 70-year-old grandmother fails to file her return believing that senior citizens do not have to pay tax? And what if the taxpayer deducts the cost of his daughter's wedding as business entertainment? As might be expected, the IRS does not treat such transgressions lightly. If the taxpayer's behavior can be characterized as negligent, a penalty in addition to the regular tax may be imposed. In 1989, Congress consolidated several existing penalties relating to negligence into a so-called accuracy-related penalty. The accuracy-related penalty is generally 20 percent of the portion of the tax underpayment. The principal accuracy-related penalties include:[19]

- Negligence or disregard of rules and regulations
- Substantial understatement of income tax
- Substantial valuation misstatement.

Note that these penalties do not stack on top of each other. The IRS must pick which one it wants to assess.

Negligence Penalty (Insubstantial). The negligence penalty, as an accuracy-related penalty, is 20 percent of the portion of the tax underpayment that is attributable to negligence or disregard of the rules and regulations.[20] For example, assume a taxpayer forgets to report $1,000 that he received for consulting during the year. If the taxpayer is in the 28 percent tax bracket, the underpayment is $280 and the penalty would be $56 (20% ×

[19] § 6662.

[20] § 6662(c).

$280). Note that when the day of reckoning comes, the taxpayer will be required to pay the underpayment, interest on the underpayment from the original due date, and the penalty, if any. The taxpayer may also owe interest on the penalty. Interest on the penalty generally starts to run when the taxpayer has been notified of the penalty, usually sometime after the audit. Under § 6601(e)(2)(B) interest must be paid on the failure-to-file penalty, accuracy-related penalties, and the fraud penalty.

Negligence is generally defined as any failure to do what a reasonable and ordinarily prudent person would do under the circumstances. To avoid the negligence penalty, the taxpayer must make a reasonable attempt to comply with the law. The negligence penalty is usually imposed when the taxpayer fails to report income or claims large amounts of unsubstantiated expenses. For example, a waitress who fails to report her cash tips would probably get hit with the penalty, as would the businessperson who claims thousands of dollars of business entertainment expenses with little or no substantiation—a specific requirement for travel and entertainment expenses. A taxpayer is automatically considered negligent and liable for the 20 percent penalty if he or she fails to report any type of income for which there is an information return filed by the party paying the income (e.g., Form 1099). In other situations, determination of whether the penalty should be imposed is in the hands of the auditor. It is important to note, however, that taxpayers who intentionally attempt to deceive the government are normally not subject to the negligence penalty but rather the more severe fraud penalty discussed below.

For most taxpayers, the most important aspect of the negligence penalty concerns its relationship to positions taken on returns.

> **Example 5.** This year D graduated with a marketing degree from the University of Arkansas and immediately took a job with a publishing company as a sales representative. The company did not provide her with an office, so she worked out of her home. After talking with her boss at work, she found out that he deducted his home office expenses as business expenses on his return. Knowing little about tax, she followed her boss's lead and deducted $3,000 of expenses related to her home office. Two years later D's return was audited and the agent informed her that he planned to deny her deduction for the home office expenses. Assuming the agent is correct, another issue is raised: should the negligence penalty apply since D has taken an incorrect position on the return?

Prior to 1994, the taxpayer could avoid the negligence penalty as long as the position was not frivolous and it was disclosed on the return. But that approach inspired taxpayers to play the audit lottery. For example, aggressive taxpayers might take a questionable deduction, disclose it, then hope that they would never be audited. Even if they got caught, there was little risk of punishment since disclosure protected them against a negligence penalty in every situation except where the position was frivolous or patently improper. In other words, as long as the position was nonfrivolous—that is, the taxpayer had some basis on which to argue the disclosed position (e.g., a merely arguable or merely colorable claim)—the negligence penalty could be avoided.[21] Believing that the ethical standard set by this rule was far too low, the Revenue Reconciliation Act of 1993 changed the rules. Under the current approach, taxpayers are forced to be more cautious about the positions they take on their returns.

A negligence penalty can be assessed unless the taxpayer has a *reasonable basis* for the position taken on the return regardless of whether it is disclosed on the return.[22] What

21 Reg. §§ 1.6662-3(b)(3) and 1.6694-2(c)(2).

22 See Predmore, "New Reasonable Basis Standard for Return Disclosure Likely to Be Troublesome," *Journal of Taxation* (January, 1994), p. 25, which indicates that, until the regulations are modified, "disclosure of a not frivolous position should suffice to avoid the negligence penalty." Discussions with other practitioners suggest that nonfrivolous positions probably can no longer be protected through disclosure.

the current approach means to taxpayers is that in situations where the potential tax understatement is insubstantial they can ethically take a position that is contrary to the rules and regulations without fear of the negligence penalty as long as the position has a reasonable basis. Of course, the critical issue here is what constitutes a reasonable basis.

Although any definition of a "reasonable basis" would be subject to debate, the regulations do provide some guidance. According to the regulations, the reasonable basis standard is met if the return position is "arguable, but fairly unlikely to prevail in court."[23] Practitioners generally interpret this to mean that a position has a reasonable basis if it has at least a 20 percent chance of succeeding (without regard to the possibility that it might not be discovered at all). Apparently, this represents a slight increase in the level of support required by the nonfrivolous standard for disclosed positions under prior law. In the final analysis, however, the standard leaves a great deal to be desired. The regulations do provide one additional insight that may be useful: the "too good to be true" rule. This rule indicates that the reasonable basis standard is not met if the taxpayer fails to make a reasonable attempt to determine the correctness of a position that seems too good to be true.

Substantial Understatement Penalty. The substantial understatement penalty, like its sibling, the negligence penalty, is an accuracy-related penalty that is 20 percent of the portion of the underpayment of tax due to any substantial understatement of income tax.[24] The understatement is considered substantial if it exceeds the larger of (1) 10 percent of the correct tax or (2) $5,000.

The major difference between the substantial understatement penalty and the negligence penalty concerns the level of authority required to avoid penalty for an erroneous *undisclosed* position. In effect, Congress is telling taxpayers that if the risky position they are taking involves a substantial amount of tax and they are *unwilling to disclose* the position, the degree of support they must have is greater than simply a reasonable basis. The substantial understatement penalty applies to undisclosed positions unless the taxpayer has *substantial authority* for the position. It is unclear what the substantial authority requirement calls for, but it seems clear that it is somewhat more stringent than the 1 in 3 test of the realistic possibility of success standard discussed below but less demanding than the more-likely-than-not requirement, a more than 50 percent chance, related to certain positions taken with respect to certain tax shelter investments. For purposes of the substantial authority analysis, only materials published by Congress, the IRS, and the courts are relevant. Conclusions suggested by tax professionals in treatises, legal periodicals (which provide the basis of many arguments), or the like are not to be considered.[25]

The degree of support necessary to avoid the substantial understatement penalty drops down a notch if the taxpayer is willing to disclose the position. The substantial understatement penalty can be avoided if the taxpayer makes *adequate disclosure* and has a *reasonable* basis for his position. What constitutes adequate disclosure is many times clearer than what constitutes a reasonable basis. Disclosure is considered adequate if the position is explained on a special form intended just for this purpose, Form 8275 or 8275-R, or on the return in accordance with rules issued by the IRS each year.[26] In effect, when the tax dollars involved are material, taxpayers must meet a much higher standard—substantial authority—than is normally applied unless they are willing to disclose the position.

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23 § 6662(d).

24 § 6662(d)(2)(B). A corporate taxpayer has a substantial understatement if the amount of the understatement exceeds the lesser of (1) 10% of the tax required to be shown on the return for the tax year (or, if greater, $10,000), or (2) $10 million.

25 Reg. § 1.6692-4(d)(3)(iii).

26 Reg. § 1.6694-2(c)(3).

Substantial Valuation Misstatement. The tax law often requires taxpayers and tax return preparers to provide valuations for certain items. For example, taxpayers are generally entitled to a deduction for the fair market value of property given to qualified charitable organizations. What happens if a taxpayer in the 30 percent bracket gives a work of art that he says is worth $6,000 when its value is really closer to $2,000? The answer is that he has saved $1,200 ($4,000 × 30%) if he wins the audit lottery. But if the IRS does catch him, the taxpayer may face an accuracy-related penalty for substantial valuation misstatement. A 20 percent penalty is imposed on the underpayment of tax attributable to the misstatement.[27] The taxpayer avoids the penalty, however, if the misstatement does not exceed 150 percent of the correct value or if the amount of tax underpayment attributable to the misstatement is less than $5,000 ($10,000 for corporations). Thus the taxpayer above, who overstated the correct value by 300 percent, would still escape the valuation penalty since the amount of tax attributable to the misstatement, $1,200, is less than the $5,000 threshold. However, the taxpayer could still be subject to the negligence or the substantial understatement penalties.

Summary of Penalties for Inaccurate Returns. There is a great deal of confusion over penalties concerning erroneous positions on tax returns and what one can do to avoid them. Nevertheless, Exhibit 2-7 summarizes the three accuracy-related penalties discussed above and what defenses are available to the taxpayer. After a great deal of studying, it may become clear that the likelihood of a penalty depends on three factors: the amount of the potential understatement, whether the taxpayer has disclosed the position adequately, and the level of support that there is for the position. As a rule, if the tax dollars are not significant, a reasonable basis protects the taxpayer from penalty. On the other hand, if the tax dollars are substantial, the taxpayer is protected only if

EXHIBIT 2-7
The 20 Percent Penalty for Inaccurate Returns and Defenses: § 6662

1. Negligence (insubstantial)
- Defined: Reasonable attempt to comply with the tax laws
- Defenses:
  - Reasonable basis (disclosure is unnecessary)
  - Exercise of reasonable care in preparing tax return
  - Reasonable cause and good faith

2. Substantial understatement
- Defined: Understatement greater than 10% of tax or $5,000, whichever is larger
- Defenses:
  - Understatement does not exceed threshold
  - Disclosure with reasonable basis
  - No disclosure with substantial authority
  - Reasonable cause and good faith

3. Substantial valuation misstatement
- Defined: Misstatement more than 150% of correct valuation
- Defenses:
  - Misstatement does not exceed threshold
  - Amount of underpayment of tax is less than $5,000
  - Reasonable cause and good faith

[27] § 6662(e). The penalty is 40 percent if the claimed value is 200 percent or more of the correct value.

EXHIBIT 2-8
Standards of Compliance Required to Avoid Penalties

1. Frivolous position
   - Defined: Patently improper
     - No protection for frivolous positions
2. Not frivolous position
   - Defined: Not patently improper, merely arguable
     - Pre-1994: Protection against negligence with disclosure
     - Post-1993: Apparently no protection
3. Reasonable basis
   - Defined: Arguable but fairly unlikely to prevail in court
     - Protects against insubstantial negligence
     - Protects against substantial understatement if position disclosed
4. Realistic possibility of success
   - Defined: More than one in three chances for success
     - Protects against insubstantial negligence without disclosure
     - Protects against substantial negligence with disclosure
5. Substantial authority
   - Defined: Supporting authorities are substantial (Congress, IRS, or court cases)
     - Protects against insubstantial and substantial negligence without disclosure (except tax shelter item)
6. More-likely-than-not
   - Defined: Greater than 50 percent chance of succeeding
     - Protects against insubstantial and substantial negligence without disclosure including tax shelter items
7. Reasonable cause and good faith
   - Defined: Facts and circumstances determination
     - Protects normally against all penalties

there is substantial authority or if there is disclosure with reasonable basis. Exhibit 2-8 summarizes the various standards of compliance and ranks them according to their level of certainty. Note that in all cases the taxpayer can avoid the penalties by showing that there was *reasonable cause* for the position taken or that he or she acted in *good faith*. Obviously, these are both purely subjective determinations based on the individual facts and circumstances.

FRAUD

When the taxpayer attempts to defraud the government, the tax law imposes a minimum penalty equal to 75 percent of the amount of underpayment attributable to the fraud.[28] *In addition*, the taxpayer may also be subject to the criminal penalties for fraud. Criminal penalties can be as high as $100,000 ($500,000 for corporate taxpayers) and imprisonment for up to five years. Despite these penalties, taxpayers by the thousands are willing to play the audit lottery, including some rich and famous tax felons:[29]

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28 § 6663.

29 See in part “Famous Faces from IRS Hall of Shame,” *Sacramento Bee*, March 29, 1994. Metro Final Scene, D3.

- Leona Helmsley, New York hotel magnate, who will forever be remembered for her offhand comment to her housekeeper, "we don't pay taxes; only the little people pay taxes." Helmsley, convicted in 1992 for deducting millions of dollars of personal expenses, including renovations to her personal residence, was fined more than $7 million and sentenced to four years in prison (served 18 months).
- Pete Rose, baseball player and all-time leader in hits (4,256). Rose failed to report income from memorabilia shows and gambling and served five months in prison.
- Spiro Agnew, vice-president during the Nixon era. Agnew, who failed to report income from bribes, was fined $10,000 and had a three-year suspended sentence.
- Chuck Berry, famous rock and roll star of Johnny B. Goode fame. Berry underreported his income by $110,000 in 1979 and served four months in prison.
- Aldo Gucci, famous designer. Gucci pleaded guilty to $7 million of tax fraud in 1989 and was sentenced to one year in jail and fined $30,000.
- Al Capone, racketeer and mobster. Capone, convicted of tax evasion in 1931, was fined $50,000 and served eight years of a ten-year sentence, then retired to his Miami estate.
- Willie Nelson, country and western singing star. Nelson ran up his tax bill to over $32 million. He served no time in prison, but part of the bill was paid from part of his ranch, which was seized by the IRS.
- Richard Hatch, winner in the debut season of reality show "Survivor." Hatch failed to report $1,000,000 and pay taxes on the winnings. He reportedly asked an accountant to prepare two tax returns, one with the winnings and the other without, and chose to file the latter. Hatch was found guilty of tax evasion and was sentenced in 2006 to serve 51 months in prison.

Civil fraud has not been clearly defined, but it requires more than simply negligent acts or omissions by the taxpayer. There is a fine line between fraud and negligence (to which a lesser penalty applies, as explained above). Fraud does not occur by accident. It is a willful and deliberate attempt to evade tax. For example, consider a taxpayer who is entitled to a deduction of $19,000. What penalty applies if he transposed the digits and claimed a deduction of $91,000? Fraud occurs only if it can be shown that the taxpayer knew that the amounts reported on the return were false. In this regard, the IRS must prove this to be true by a "preponderance of evidence." Thus for the transposition error above, the fraud penalty can be upheld if the IRS can carry its burden of proof and show that the taxpayer intentionally transposed the numbers. Lacking this, the negligence or substantial understatement penalty would probably be assessed. Note that before the *criminal* fraud penalty can be imposed, the IRS must show that the taxpayer intentionally tried to evade tax "beyond a shadow of any reasonable doubt." All of those in the "hall of shame" above found that this is not an impossible task. As a practical matter, the penalty imposed—negligence, civil, or criminal fraud—depends on the severity of the offense and the ability of the IRS to carry the burden of proof.

Example 6. Dr. Bradford Calloway paid his children, all of whom were under 12 years of age, $11,000 for performing various tasks relating to his business. The kids did such chores as mail sorting, trash collecting, and answering the telephone. Although expenses incurred in carrying on a business such as these are normally deductible, the IRS did not believe that children that age could perform work worth that much money for any business. The Tax Court agreed with the IRS, and the judge added a fraud penalty, explaining that "We find it inherently incredible that Calloway, an intelligent and educated professional man, would pay a total of $11,138.56 for such services, performed by small children on a part-time basis, or that he could seriously believe that such payments represented reasonable and deductible compensation for services rendered in his medical practice . . . particularly in the face of his accountant's contrary advice."[30]

TAX PREPARER PENALTIES

Understanding the penalty structure becomes doubly hard when a tax preparer is involved. What are the responsibilities of tax preparers when the client is unscrupulous or simply wants to take an aggressive position? As a practical matter, it is not the totally dishonest taxpayer that presents difficulties for tax return preparers. Most practitioners can easily walk away from such engagements. The more perplexing and more common problems concern situations where the client wants the preparer to take an aggressive position on issues for which the answer is unclear. Similarly, taxpayers may want to pursue a particular position because they view the law as arbitrary or capricious or they are not receptive to the preparer's response. These situations often present an ethical dilemma for the preparer. What side should the practitioner take? Should the preparer sign the return if he or she disagrees with the taxpayer? First, it needs to be emphasized that the tax practitioner is being paid to be an advocate for the client, not an independent third party hired to provide an unbiased or neutral opinion. It is the job of the tax expert to explain the relevant considerations and possible consequences, including positions that may be contrary to the law but which may be defensible. That done, it is not the right of the practitioner to impose his or her own set of moral values on the client. The final decision is to be made by the client after reviewing the alternatives provided. If the practitioner believes that the client's actions violate his or her personal code of ethics, the practitioner should withdraw from the engagement.

Beyond the basic preparer-client relationship, there are a number of other forces at work that affect whether the preparer signs the return containing a risky position. First, even if an answer to a particular question does exist, the costs of uncovering it probably cannot be recovered from the client. Second, given the small percentage of tax returns that are audited, there is only a slight chance that either the taxpayer or preparer will ever come face to face with the IRS. Third, preparers, like most people, want to please their customers and find it hard to just say no. When these dynamics are present, they make it relatively easy for practitioners to resolve an issue in favor of the client, notwithstanding the lack of reasonable support for the position. This is particularly true when the practitioner knows that the unprincipled competitor down the street will do whatever the client wants and at a cheaper price. On the other hand, the practitioner's sense of public duty, concern about his or her personal and professional reputation, and possible legal liability may cause him or her to be something less than an advocate for the client. As might be expected, the practitioner's proper role in these situations is not clearly defined. There are, however, in addition to the preparer's own personal code of ethics, some guidelines that a preparer generally must follow in carrying on a tax practice.

Individuals who prepare tax returns are subject to a variety of rules regulating their professional conduct. The rules governing tax practice are contained in Treasury Circular Number 230 and various provisions of the Internal Revenue Code. In addition, CPAs and attorneys engaged in tax practice must also follow the rules of conduct imposed by their professional organizations: the American Institute of Certified Public Accountants (AICPA) and the American Bar Association (ABA). The general rules of conduct prescribed by the AICPA for all CPAs concern a variety of matters such as independence, integrity, objectivity, advertising, contingent fees, and responsibilities of the accountant when undertaking an engagement—but none of these are directly related to tax practice. Acknowledging that individuals engaged in tax practice have ethical concerns beyond those covered in the general rules of conduct, the AICPA has developed Statements on

[30] A. J. Cook, *A. J.'s Tax Court* (St. Luke's Press, 1987), p. 96.

Standards for Tax Services (SSTSs). These statements, currently eight in number, provide additional guidelines for professional conduct of CPAs in tax practice. Similarly, the ABA Standing Committee on Ethics and Professional Responsibility has also issued certain opinions regarding an attorney's conduct when practicing before the IRS.

Tax Return Positions. As might be imagined, the rules and applicable penalties concerning practitioner conduct as set forth by Circular 230, the Internal Revenue Code, the AICPA, and the ABA deserve a chapter devoted solely to these topics. In essence, however, the most important penalty for those preparing returns is that contained in § 6694(a) as recently revised in 2007. Section 6694(a) provides that a penalty of $1,000 (or if greater, 50% of the income from preparing the return) is imposed on the preparer of a tax return if any part of an understatement of the liability on a return is due to an *undisclosed* position for which the return preparer did not have a reasonable belief that the position was *more likely than not* correct.[31] If the position is disclosed, the penalty is not imposed as long as the position had a reasonable basis.[32] The more-likely-than-not standard is met if the preparer believes that if the issue were litigated, the taxpayer would have a greater than fifty percent chance of prevailing. Note that the penalty applies to any paid preparer regardless of whether the person is a CPA, enrolled agent, friend, or relative. If the preparer is compensated, the penalty could apply.[33]

Example 7. T purchased a computer this year that he uses in his job as a financial planner. His friends at the office say that he can deduct it. His accountant, P, explained that it might be deductible but only if T can demonstrate that the computer's use is for his employer's convenience and not his own. T believes it is. P has reservations but signs the return. The position is not disclosed. T avoids penalty on an undisclosed position as long as there is a reasonable basis for the position. In contrast, P avoids penalty on an undisclosed position only if the position is more-likely-than-not to succeed. If the deduction is later denied, P could owe a penalty while T would not.

Example 8. Same facts as in Example 7 above except the amount of the potential understatement of tax is greater than 10 percent of T's total tax. In this case, T, avoids penalty for an undisclosed position if he has substantial authority, while P avoids penalty if the more-likely-than-not standard is met.

As the examples may suggest, practitioners have severely criticized the disconnect between the penalties and are already calling for the differences to be eliminated.[34]

At first glance, it would appear that the size of penalty imposed by the IRS, $1,000, is so small that it would do little to dissuade preparers from taking whatever position a client wishes. What may not be apparent, however, is the significance of this standard *and* its violation should a disgruntled client end up suing the preparer for malpractice. In a

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31 The penalty increases to the greater of $5,000 or 50% of the income derived from preparation of the return if it is attributable to willful or reckless conduct. See § 6694(b).

32 Disclosure must be made on Form 8275 or, when the position is contrary to a Regulation, Form 8275-R. See Reg. § 1.6694-2(c)(3)(i).

33 See § 7701(a)(36) for a definition of preparer.

34 Other disconnects also exist. The AICPA SSTS No. 1 states that an AICPA member should not recommend a position unless the position has a realistic possibility of success. The ABA and Circular 230 also embrace the lower realistic possibility standard.

civil action against a preparer, the courts, both judges and juries, typically rely on expert testimony to assess whether the preparer should be held liable. In such case, it is not too hard to imagine a judge or jury believing that the preparer was negligent once an expert has explained that the preparer has already been penalized under § 6694(a). Even if the preparer is ultimately exonerated, the costs to defend such action could be substantial. Moreover, failing to observe such a standard could ultimately cost the practitioner the loss of his or her professional license to practice as a CPA or attorney. In short, it is not the size of the penalty that the practitioner fears but the other consequences that the penalty may trigger.

> **Example 9.** T, a CPA, has prepared the tax return for D&G Home Products for the past 15 years. It is normally a week-long job and worth well over $10,000 to T's practice. He also does the monthly preparation of financial statements worth another $20,000 per year. This year G spent more than $100,000 on a Super Bowl excursion for its customers. In preparing the return, D&G insists that it should be able to deduct all of the expenses, but T has some reservations. T understands there have been some recent changes in the law in this area but does not have time to adequately research the issue, and, even if he did, he doubts whether he could charge for the time spent. He also knows that this is a lucrative engagement and he wants to continue the relationship with the client. Finally, T recognizes that it is highly unlikely that the return will ever be audited. Consequently, T decides to sign the return and worry about it only if a problem arises. But what happens if the return is audited, the position is overturned, and a preparer penalty is assessed on the grounds that the return contained an undisclosed position that did not have a more-likely-than-not chance of succeeding? While the penalty would be monetarily small, the real concern is the effect of the reversal on the client. D&G may have a short memory once it is forced to pay the tax, interest, and perhaps a substantial understatement penalty and interest on the penalty. It may not remember conversations with T and his admonitions. In the end, the corporation may feel that it was misled and sue T for malpractice and thousands of dollars. In such a proceeding, D&G may have the upper hand since it has been determined by a court of law that the position was unrealistic under that standards of § 6694(a) and T has therefore failed to meet his ethical responsibilities.

The decision that all practitioners ultimately face with every return they prepare is whether they can in good faith sign the tax return as preparer. Under the current rules, preparers normally will be reluctant to sign if the return contains an undisclosed position that does not have a more-likely-than-not chance of succeeding. More importantly, proposed changes of Circular 230 specifically state that a practitioner cannot sign a tax return unless the more-likely-than-not threshold is met for each undisclosed position on the return or alternatively, the positions are disclosed and each has a reasonable basis.[35] As many commentators have lamented, practitioners often may not be able to determine whether the threshold can be reached.

In addition to the $1,000 penalty, the tax law provides a number of other penalties to encourage ethical conduct by preparers. For example, a penalty of $1,000 per return is imposed where the preparer willfully attempts to understate the liability of the taxpayer or where the preparer understates the taxpayer's liability by reckless or intentional disregard of the rules or regulations.[36] The law also contains a number of

35 Prop Reg § 10.34

36 § 6694(b).

criminal penalties for preparers with fines of up to $10,000 and imprisonment for up to three years.[37]

Other Guidelines for CPAs. As suggested above, the Statements on Standards for Tax Services provide a number of other guidelines for members of the AICPA who are tax practitioners. There are currently eight statements. *SSTS No. 1*, regarding tax positions, was mentioned above. The remaining statements generally fall into one of two categories: (1) return preparation issues (SSTS Numbers 2, 3, and 4) and (2) issues that arise after a return is filed (SSTS Numbers 5, 6, and 7). Some of these statements are summarized below.

- *SSTS No. 2: Answers to Questions on the Return.* When there are questions on a return that have not been answered, the CPA should make a reasonable effort to obtain appropriate answers from the taxpayer and provide the answers to the questions on the return. The significance of the question in terms of the information's effect on taxable income or loss and tax liability may be considered in determining whether the answer to a question may be omitted. However, omission of an answer is not justified simply because the answer may prove to be disadvantageous to the taxpayer.

- *SSTS No. 3: Certain Procedural Aspects of Preparing Returns.* In preparing or signing a return, a CPA may, without verification, rely in good faith on information furnished by the taxpayer or a third party. However, the CPA cannot ignore the implications of information furnished, and should make reasonable inquiries if the information appears to be incorrect, incomplete, or inconsistent either by itself or on the basis of other facts known to the CPA. When preparing the current return, the CPA should make use of returns from prior years wherever feasible. If the tax law or regulations impose conditions with respect to the tax treatment of an item (e.g., substantiating documentation), the CPA should make appropriate inquiries to determine if the conditions are met. In addition, when preparing a return, the CPA should consider relevant information known to the CPA from the tax return of another taxpayer, but should also consider any legal limitations relating to confidentiality.

- *SSTS No. 4: Use of Estimates.* Unless it is prohibited by the Internal Revenue Code or other tax rule, a CPA may prepare returns involving the use of the taxpayer's estimates, if under the circumstances, exact data cannot be obtained in a practical manner. When estimates are used, they should be presented in such a manner as to avoid the implication of greater accuracy than that which exists. The CPA should be satisfied that estimated amounts are reasonable under the circumstances.

- *SSTS No. 6: Knowledge of Error (Return Preparation).* A CPA should advise the taxpayer promptly upon learning of an error in a previously filed return, or upon learning of a taxpayer's failure to file a required return. The advice of the CPA may be oral, and should include a recommendation of the measures to be taken. The CPA is not obliged to inform the IRS and may not do so without the permission of the taxpayer, except where required by law. If the CPA is requested to prepare the current year's return and the taxpayer has not taken appropriate steps

[37] See §§ 7206, 7207, and 7216.

to correct an error on a prior year's return, the CPA should consider whether to withdraw from preparing the return and whether to continue a professional or employment relationship with the taxpayer.

- *SSTS No. 7: Knowledge of Error (Administrative Proceeding).* When the CPA represents a taxpayer in an administrative proceeding regarding a return with an error known to the CPA that has resulted or may result in more than an insignificant effect on the taxpayer's tax liability, the CPA should notify the taxpayer and recommend corrective measures to be taken. The recommendations may be given orally. The CPA is not obligated to inform the IRS or other taxing authority, and may not do so without the taxpayer's permission, except where required by law. However, the CPA should request permission from the taxpayer to disclose the error to the IRS. Absent such permission, the CPA should consider withdrawing from the engagement.

Circular 230 Changes. In 2005, Circular 230 was changed to require those who practice before the IRS to disclose to their clients when the advice they give to them cannot be relied on for purposes of mitigating penalties that might be imposed on them. In practice, this means that lawyers, CPAs and other tax practitioners affix a disclaimer somewhat like that which follows to all written communications with clients that do not constitute a full legal option. The disclaimer must be placed on faxes, e-mails, blackberries and regular written correspondence.

> DISCLAIMER: Any federal tax advice contained in this communication (including attachments) was not intended or written to be used, and it cannot be used, by you for the purpose of (1) avoiding any penalty that may be imposed by the Internal Revenue Service or (2) promoting, marketing or recommending to another party any transaction or matter addressed herein.

The above discussion is just a brief introduction to the penalties and rules of practice that serve to define the proper conduct for taxpayers and preparers. In reality, there are a number of other penalties and rules that may apply in certain situations.[38] Nevertheless, this introduction may provide a sense of what are the most common ethical problems facing tax practitioners. Moreover, it underscores the importance of being able to find authoritative answers for questions, the subject of the next section.

✓ CHECK YOUR KNOWLEDGE

Review Question 1. The system of penalties provides an escape for taxpayers if the positions taken on their returns meet certain standards. In effect, meeting a certain standard enables the taxpayer to avoid a penalty. Practitioners generally associate a probability of success rate for each standard. What probabilities would you assign?

Frivolous	____________
Substantial authority	____________
Nonfrivolous	____________
More-likely-than-not	____________
Reasonable basis	____________
Realistic possibility of success	____________

None of these probabilities other than *realistic possibility of success* have been quantified by the law. However, practitioners would typically rank the standards in the following

[38] For a more complete discussion, see the related text, *Corporate Partnership, Estate and Gift Taxation, 2009 Edition*, Chapter 18.

order with the associated probabilities of success. Although the probabilities might vary from firm to firm and practitioner to practitioner, the order would remain the same.

1.	More-likely-than-not	> 50%
2.	Substantial authority	≥ 40
3.	Realistic possibility of success	≥ 33
4.	Reasonable basis	≥ 20
5.	Nonfrivolous	≥ 5
6.	Frivolous	< 5

Review Question 2. Pete Hartman operates an accounting practice in northern Virginia just outside of Washington. One of his long-time clients is Jim Anderson. Last year the IRS audited Jim's 2003 tax return, and he ultimately had to pay additional taxes as well as interest on that amount. Jim now wants to deduct a portion of this interest as a business expense. He reasons that because business expenses are deductible and the interest was directly attributable to back taxes on business income, the deduction should be allowed. There has also been another development this year. Jim's daughter has been diagnosed to have dyslexia. The problem is not severe but it was enough to cause Jim to enroll his daughter in a private school that is better equipped to provide the additional help she needs. The tuition for the school is $20,000, and Jim wants to deduct the cost as a medical expense. After some research, Pete believes that both positions are somewhat risky. Jim has asked Pete about the downside risk of taking this position on his return. Pete estimates that taking the deduction for the interest will reduce Jim's tax liability of $30,000 about $1,000. If he were to claim only the medical expense deduction by itself, it would reduce his tax liability by about $6,000. Try to answer the following questions.

a. What is the maximum penalty that Jim might pay if he deducts only the interest and it is considered erroneous but not fraudulent?

Jim would be subject to an accuracy-related penalty (negligence), which is 20 percent of the amount of the underpayment due to the overstatement of deductions. In this case, the penalty would be $200 (20% × $ 1,000). In addition, Jim would owe the additional $1,000 in tax plus interest on the underpayment *and* interest on the penalty.

b. True-False. Jim will not be subject to penalty with respect to the interest deduction as long as his position has a reasonable basis even if he does not specifically disclose the position on the return since the amount of tax at stake is not substantial.

True. The negligence penalty will not be assessed as long as the taxpayer has a reasonable basis for the position regardless of whether the position is disclosed on the tax return.

c. True-False. Jim will not be subject to penalty with respect to the tuition deduction as long as his position has a reasonable basis even if he does not specifically disclose the position on the return.

False. In this situation, Jim's $6,000 understatement would be considered substantial since it exceeds the larger of $5,000 or 10 percent of the correct tax, $3,000 (10% × $30,000). When the understatement in question is substantial, the substantial understatement penalty applies. This penalty can be avoided only if the taxpayer has substantial authority for his position *or* he discloses the position and such position has reasonable basis. Here Jim will not have disclosed the position, so a reasonable basis for the position will not suffice.

d. Jim has indicated that he does not want to flag either position. Pete would not be subject to a preparer penalty with respect to the tuition deduction if the position is *not* disclosed as long as the position:

(1) has a reasonable basis
(2) is nonfrivolous
(3) has a realistic possibility of success
(4) has a more-likely-than-not chance of prevailing
(5) all of the above

(4). To avoid the $1,000 preparer penalty of § 6694(a), an undisclosed position must have a more-likely-than-not possibility of being correct. However, if the position is disclosed, the preparer penalty will not apply as long as it there is a reasonable basis for the position.

e. True-False. By signing the tax return, Pete would not be violating the Circular 230 standards assuming both positions have a reasonable basis.

False. Circular 230 has also adopted the more-likely-than-not standard, mandating that tax practitioners should not sign returns containing undisclosed positions that do not meet this standard.

f. Pete understands that the SSTS indicate that he is not supposed to sign the return where there is an undisclosed position unless the position has a realistic possibility of success. However, he has no real idea whether the chances are 20 percent, 30 percent, 40 percent, or whatever based on what he has found. Can Pete sign a return containing a position for which there is no reasonable basis without violating the AICPA statements if he discloses the position?

Yes. The SSTS provide that a practitioner can sign any return as long as the position is disclosed and it is not frivolous.

PROBLEM MATERIALS

DISCUSSION QUESTIONS

2-1 *Taxpayer Penalties.* In reviewing his last year's return, T noticed that he had inadvertently deducted the entire cost of a new air-conditioning system. Such cost should have been capitalized and depreciated.

a. T wants to know what penalties, if any, might be assessed if his return is audited and the IRS uncovers his mistake.
b. What should T do?

2-2 *Tax Positions.* R operates a small accounting practice in Columbus, Ohio. While preparing the return for his long-time client C, he found out that C wants to deduct the cost of lawn care for her home. C is a landscape architect who recently started using a room at her home as an office. She feels that this is clearly a business expense. During the interview she seemed to have a point. "What if my clients came to my house and the yard was less than picture perfect? It would kill my business," she explained. R has reviewed the proposed regulations on the home office deduction, and they specifically state that lawn care is not deductible. Nevertheless, he understands C's point. R just cannot say no, and he is thinking about preparing the return and deducting a portion of lawn care allocable to C's home office.

a. Assume the position is erroneous and is not disclosed. Will C be subject to any penalty? Explain.

b. Assume the position is erroneous and is disclosed. Will C be subject to any penalty? Explain.

2-3 *Avoiding Preparer Penalties.* H recently quit a national public accounting firm and purchased the practice of a local accountant. Her first busy season with this new set of clients has been eye-opening. Some of the taxpayers have been taking very questionable positions on certain recurring items. Somewhat paranoid, H is now quite concerned about incurring penalties. What can she do to guard against possible preparer penalties?

2-4 *Knowledge of Error.* Last March, P put the finishing touches on the tax return of one of his most prized clients, Great Buy Corporation. When preparing the monthly financial statement for June, P noticed that $30,000 of sales somehow got left off of the return. What should P do?

2-5 *Knowledge of Error.* This year P got a new client from the firm down the street, Dewey, Cheatham and Howe. After reviewing the client's prior year return, he found, as he had expected, an error in the way Dewey had computed depreciation. What should P do?

2-6 *Making a New Tax Law.* Describe the Congressional process of making a tax bill into final law.

2-7 *Legislative vs. Interpretative Regulations.*Explain the difference between a legislative Treasury Regulation and an interpretative Regulation.

2-8 *Proposed vs. Final Regulations.*Distinguish between proposed and final Regulations. How would either type of Regulation involving Code § 704 be cited?

2-9 *Revenue Rulings and Revenue Procedures.* Distinguish between a Revenue Ruling and a Revenue Procedure. Where can either be found in printed form?

2-10 *Private vs. Published Rulings.* Distinguish between a private letter ruling and a Revenue Ruling. Under what circumstances would a taxpayer prefer to rely on either of these sources?

2-11 *Technical Advice Memoranda.* What are Technical Advice Memoranda? Under what circumstances are they issued?

2-12 *Trial Courts.* Describe the trial courts that hear tax cases. What are the advantages or disadvantages of litigating a tax issue in each of these courts?

2-13 *The Appeals Process.* A taxpayer living in Indiana has exhausted her appeals within the IRS. If she chooses to litigate her case, trace the appeals process assuming she begins her effort in each of the following trial courts:

a. The U.S. Court of Federal Claims
b. The U.S. District Court
c. The U.S. Tax Court
d. The Small Tax Division of the U.S. Tax Court

2-14 *Tax Court Decisions.* Distinguish between a Regular Tax Court decision and a Memorandum decision.

2-15 *Authority of Tax Law Sources.*Assuming that you have discovered favorable support for your position taken in a controversy with an IRS agent in each of the sources listed below, indicate how you would use these authoritative sources in your discussion with the agent.

a. A decision of the U.S. District Court having jurisdiction over your case if litigated

b. Treasury Regulation

c. The Internal Revenue Code

d. A decision of the Supreme Court

e. A decision by the Court of Appeals

f. A decision of the Small Claims Court

g. A decision of the U.S. Tax Court

h. A private letter ruling issued to another taxpayer

i. A Revenue Ruling

j. A tax article in a leading periodical

2-16 *Tax Services.* What materials are generally found in leading tax services? Which does your library have?

? *YOU MAKE THE CALL*

2-17 T is the owner of a small CPA firm that has developed a very good auditing and tax practice over the years. Recently, while visiting the home of S, his best client (revenues of about $50,000 annually for audit and tax services), T learned some very disturbing information about S's business practices. During a tour of her home, S accidentally revealed that some very expensive personal entertainment equipment acquired in 2007 had been charged to her corporation (cost of approximately $100,000). S stated that everyone she knew charged personal assets to their business accounts and that it appeared to be generally accepted practice. She said she hoped T would not mind.

When T returned to his office, he immediately checked S's 2007 corporate income tax return and found that depreciation had been taken on the $100,000 cost of assets listed simply as "Equipment." Of course, T never suspected the assets were for personal use in S's home.

What should T do? This client is too good to lose, but T is worried about the consequences of allowing this type of behavior to continue.

PROBLEMS

2-18 *Interpreting Citations.* Interpret each of the following citations:

a. Reg. § 1.721-1(a).

b. Rev. Rul. 60-314, 1960-2 C.B. 48.

c. Rev. Proc. 86-46, 1986-2 C.B. 739.

d. Rev. Rul. 98-36, I.R.B. No. 31, 6.

e. § 351.

2-19 *Citation Abbreviations*. Explain each of the abbreviations below.

a. B.T.A.
b. Acq.
c. D. Ct.
d. CA-9
e. F.Supp.
f. NA.
g. Ct. Cls.
h. USTC
i. AFTR
j. *Cert. Den.*
k. *aff'g* and *aff'd*
l. *rev'g* and *rev'd*
m. *rem'g* and *rem'd*

2-20 *Interpreting Citations*. Identify the publisher and interpret each of the following citations:

a. 41 TCM 289.
b. 93 S. Ct. 2820 (USSC, 1973).
c. 71-1 USTC ¶9241 (CA-2, 1971).
d. 236 F.Supp. 761 (D. Ct. Va., 1974).
e. T.C. Memo 1977-20.
f. 48 T.C. 430 (1967).
g. 6 AFTR2d 5095 (CA-2, 1960).
h. 589 F.2d 446 (CA-9, 1979).
i. 277 U.S. 508 (USSC, 1928).

2-21 *Citation Form*. Record the following information in its proper citation form.

a. Part 7, subdivision (a)(2) of the income tax Regulation under Code § 165
b. The 34th Revenue Ruling issued March 2, 1987, and printed on pages 101 and 102 of the appropriate document
c. The 113th letter ruling issued the last week of 1986

2-22 *Citation Form*. Record the following information in its proper citation form.

a. A 1982 U.S. Tax Court case in which Roger A. Schubel sued the IRS Commissioner for a refund, published in volume 77 on pages 701 through 715 as a Regular decision
b. A 1974 U.S. Tax Court case in which H. N. Schilling, Jr. sued the IRS Commissioner for a refund, published by (1) Commerce Clearing House in volume 33 on pages 1097 through 1110 and (2) Prentice Hall as its 246th decision that year
c. A 1966 Court of Appeals case in which Boris Nodiak sued the IRS Commissioner in the second Circuit for a refund, published by (1) Commerce Clearing House in volume 1 of that year at paragraph 9262, (2) Prentice Hall in volume 17 on pages 396 through 402, and (3) West Publishing Company in volume 356 on pages 911 through 919.

RESEARCH PROBLEMS

2-23 *Using a Citator*. Use either the Commerce Clearing House or Research Institute of America Citator in your library and locate *Richard L. Kroll, Exec. v. U.S.*

a. Which Court of Appeals Circuit heard this case?
b. Was this case heard by the Supreme Court?
c. James B. and Doris E. Wallach are included in the listing below the citation for Kroll. In what court was the Wallach case heard?

2-24 *Using a Citator*. Using any available citator, locate the case of *Corn Products v. Comm.*, 350 U.S. 46. What effect did the decision in *Arkansas Best v. Comm.* (58 AFTR2d 86-5748, 800 F.2d 219) have on the precedential value of the *Corn Products* case?

2-25 *Locating Court Cases*. Locate the case of *Robert Autrey, Jr. v. United States*, 89-2 USTC ¶9659, and answer the following questions.

a. What court decided the case on appeal?
b. What court originally tried the case?
c. Was the trial court's decision upheld or reversed?

2-26 *Locating Court Cases*. Locate the case of *Fabry v. Commissioner*, 111 T.C. 305, and answer the following questions.

a. What court tried the case?
b. Identify the various types of precedential authority the judge used in framing his opinion.

2-27 *Locating Court Cases*. Locate the cited court cases and answer the questions below.

a. *Stanley A. and Lorriee M. Golanty*, 72 T.C. 411 (1979). Did the taxpayers win their case?
b. *Hamilton D. Hill*, 41 TCM 700, T.C. Memo ¶71,127 (1971). Who was the presiding judge?
c. *Patterson (Jefferson) v. Comm.*, 72-1 USTC ¶9420, 29 AFTR2d 1181 (Ct. Cls., 1972). What was the issue being questioned in this case?

2-28 *Completing Citations*. To the extent the materials are available to you, complete the following citations:

a. Rev. Rul. 98-60, ________C.B. _______.
b. *Lawrence W. McCoy*, _________T.C. _________(1962).
c. *Reginald Turner* _________ TCM ________ T.C. Memo 1954-38.
d. *RCA Corp. v. U.S.*, ______ USTC ________ (CA-2, 1981).
e. *RCA Corp. v. U.S.*, _______ AFTR2d _______ (CA-2, 1981).
f. *RCA Corp. v. U.S.*, _________ F.2.d _________ (CA-2, 1981).
g. *Comm. v. Wilcox*, ________ S. Ct. ________ (USSC, 1946).
h. _________, 79-1 USTC ¶9139 (USSC, 1979).
i. _________, 34 T.C. 842 (1960).
j. *Brian E. Knutson*, 60 TCM 540, T.C. Memo _________.
k. *Samuel B. Levin v. Comm.*, 43 AFTR2d 79-1057 (_________).

2-29 *Examination of Tax Sources*. For each of the tax sources listed below, identify at least one of the tax issues involved. In addition, if the source has a temporary citation, provide its permanent citation (if available).

a. *Battelstein Investment Co. v. U.S.*, 71-1 USTC ¶9227, 27 AFTR2d 71-713, 442 F.2d 87 (CA-5, 1971).
b. *Joel Kerns*, 47 TCM, __________T.C. Memo 1984-22.
c. *Patterson v. U.S.*, 84-1 USTC ¶9315 (CA-6, 1984).
d. *Webster Lair*, 95 T.C. 484 (1990).
e. *Thompson Engineering Co., Inc.*, 80 T.C. 672 (1983).
f. *Towne Square, Inc.*, 45 TCM 478, T.C. Memo 1983-10.
g. Rev. Rul. 85-13, I.R.B. No. 7, 28.
h. Rev. Proc. 85-49, I.R.B. No. 40, 26.
i. *William E Sutton, et al. v. Comm.*, 84 T.C. __________No. 17.
j. Rev. Rul. 86-103, I.R.B. No. 36, 13.
k. *Hughes Properties, Inc.*, 86-1 USTC ¶9440, 58 AFTR2d 86-5062, _________ U.S. __________(USSC, 1986).
l. Rev. Rul. 98-27, I.R.B. No. 22, 4.

2-30 *Office in the Home.* T comes to you for advice regarding the deductibility of expenses for maintaining an office in his home. T is currently employed as an executive vice president for Zandy Corporation. He has found it impossible to complete his job responsibilities during the normal forty-hour weekly period. Although the office building in which he works is open nights and weekends, the heating and air-conditioning systems are shut down at night (from 6 p.m.) and during the entire weekend. As a result, T has begun taking work home with him on a regular basis. The work is generally done in the den of T's home. Although T's employer does not require him to work at home, T is convinced that he would be fired if his work assignments were not completed on a timely basis. Given these facts, what would you advise T about taking a home-office deduction?

Partial list of research aids:

§ 280A
Proposed Reg. § 1.280A
M.G. Hill, 43 TCM 832, T.C. Memo 1982-143

2-31 *Journal Articles.* Refer to *Problem 2-30*. Consult an index to periodicals (e.g., AICPA's *Accountants Index*; Warren, Gorham, and Lamont's *Index to Federal Tax Articles*; or CCH's *Federal Tax Articles*) and locate a journal article on the topic of tax deductions for an office in the home. Copy the article. Record the citation for the article (i.e., author's name, article title, journal name, publication date, and first and last pages of the article) at the top of your paper. Prepare a two-page summary of the article, including all relevant issues, research sources, and conclusions. Staple your two-page summary to the article. The grade for this exercise will be based on the relevance of your article to the topic, the accuracy and quality of your summary, and the quality of your written communication skills.

2-32 *Deductible Medical Expenses.* B suffers from a severe form of degenerative arthritis. Her doctor strongly recommended that she swim for at least one hour per day in order to stretch and exercise her leg and arm muscles. There are no swimming pools nearby, so B spent $15,000 to have a swimming pool installed in her back yard. This expenditure increased the fair market value of her house by $5,000. B consults you about whether she can deduct the cost of the swimming pool on her individual tax return. What do you recommend?

Hint: You should approach this problem by using the tax service volumes of either Commerce Clearing House or Research Institute of America. Both tax services are organized according to Code Sections, so you should start with Code § 213. You will find the Code Sections on the back binding of the volumes. Research Institute of America has a very extensive index, so look under the term "medical expenses."

2-33 *Deductible Educational Expenses.* T is a CPA with a large accounting firm in Houston, Texas. He has been assigned to the international taxation group of his firm's tax department. As a result of this assignment, T enrolls in an international tax law course at the University of Houston Law School. The authorities of the University require T to enroll as a regular law student; and, theoretically, if he continues to attend courses, T will graduate with a law degree. Will T be able to deduct his tuition for the international tax law course as a business expense?

Hint: Go to either the RIA or CCH tax service and use it to find the analysis of Code § 162. When you have found the discussion of § 162, find that part of the subsection dealing with educational deductions. Read the appropriate Regulations and then note the authorities listed after the Regulations. Read over the summaries provided and then choose those you think have the most relevance to the question asked above. Read these cases and other listed authorities, and formulate a written response to the question asked in light of these cases and other authorities Finally, for the authorities you choose, go to the RIA or CCH Citator and use it to ensure that your authorities are current.