

CHAPTER 2

WORKING WITH THE TAX LAW

LECTURE NOTES

OVERVIEW

Federal tax law is a mixture of statutory provisions, administrative pronouncements, and court decisions. Anyone who has attempted to work with this body of knowledge is familiar with its complexity. Tax research provides the vehicle by which one makes sense out of this complexity.

SUMMARY OF CHANGES IN THE CHAPTER

The following are notable changes in the chapter from the 2018 Edition. For major changes, see the Preface of the text.

- Created new Big Picture example and updated related examples throughout the chapter.
- Revised text to reflect Tax Cuts and Jobs Act (TCJA) of 2017 changes as needed.
- Updated references and citations throughout the chapter.
- Updated discussion of taxation on the CPA exam.

THE BIG PICTURE

The Big Picture discussion in Chapter 2 introduces the introductory tax student to the idea that answers to tax questions will not always be found in the tax textbook and that research often needs to be undertaken to answer the question.

The discussion in Section 2-3 of the chapter takes the student through the answer to the research questions posed. Depending on the research services available, the instructor might ask the students to formulate keyword searches and then demonstrate what happens when those searches are undertaken in the research service. The instructor could ask the students to see if they could verify the correctness of the textbook conclusion or change one of the key facts and determine how the conclusion would change, if at all.

TAX SOURCES

Statutory Sources of the Tax Law

1. Statutory sources of law include the Constitution (Article I, Sections 7, 8, and 10), tax treaties, and the Internal Revenue Code.
2. Origin of the Internal Revenue Code.

- a. Known as the Internal Revenue Code of 1939, the codification arranged all Federal tax provisions in a logical sequence and placed them in a separate part of the Federal statutes.
 - b. A further rearrangement took place in 1954 and resulted in the Internal Revenue Code of 1954, which continued in effect until 1986, when it was replaced by the Internal Revenue Code of 1986.
 - c. Although Congress did not recodify the law in the Tax Reform Act (TRA) of 1986, the magnitude of the changes made by TRA of 1986 did provide some rationale for renaming the Federal tax law the Internal Revenue Code of 1986.
3. The Legislative Process.
- a. Exhibit 2.1 in the text illustrates the legislative process for enacting changes to the Internal Revenue Code of 1986.
 - b. Tax legislation normally originates in the House Ways and Means Committee of the House of Representatives because the U.S. Constitution mandates that revenue raising bills begin in the House. A tax bill might originate in the Senate when it is attached to other legislative proposals.
 - c. Tax legislation is referred from the Senate Finance Committee to the entire Senate. If the House and Senate tax bills disagree, the Joint Conference Committee resolves the differences. (See Exhibit 2.2 in the text.)
 - d. The Committee Reports explain the provisions of the proposed legislation and are a valuable source for ascertaining the intent of Congress. What Congress had in mind when it considered and enacted tax legislation is, of course, the key to interpreting the legislation by taxpayers, the IRS, and the courts.
4. Arrangement of the Internal Revenue Code. The Internal Revenue Code of 1986 is found in Title 26 of the U.S. Code. In working with the Code, it helps to understand the format. The key is usually the section number. For example, in citing Section 2(a), it is unnecessary to include Subtitle A, Chapter 1, Subchapter A, Part I. Mentioning Section 2(a) is sufficient.
5. Citing the Code. See the description in the text for form used to reference Code Sections.

Administrative Sources of the Tax Law (See Exhibit 2.3 in the text.)

6. Treasury Department Regulations. The Treasury Department under § 7805(a) has a duty to issue rules and regulations to explain and interpret the Code.
- a. Regulations, which carry considerable authority as the official interpretation of tax law, may be issued in proposed, temporary, or final form.

- (1) New Regulations and changes to existing Regulations are usually issued in proposed form before they are finalized. The interval between the proposal of a Regulation and its finalization permits taxpayers and other interested parties to comment on the propriety of the proposal. Proposed Regulations carry little weight.
 - (2) Final Regulations have the force and effect of law. Final Regulations are issued as Treasury Decisions (TDs) in the *Federal Register*. Regulations carry considerable authority as the official interpretation of tax statutes.
 - (3) Temporary Regulations are issues where immediate guidance is important.
 - b. Proposed, Temporary, and final Regulations are published in the *Federal Register*, in the *Internal Revenue Bulletin*, and by major tax services.
 - c. Regulations may also be classified as legislative, interpretive, or procedural.
7. Revenue Rulings and Revenue Procedures.
- a. Revenue Rulings are official pronouncements of the National Office of the IRS and provide guidance to both IRS personnel and taxpayers in handling routine tax matters. They usually deal with more restricted problems than Regulations and do not carry the same legal force and effect as Regulations.
 - b. Revenue Procedures are issued in the same manner as Revenue Rulings, but they deal with the internal management practices and procedures of the IRS. Revenue Procedures do not carry the same legal force and effect as Regulations.
 - c. Both Revenue Rulings and Revenue Procedures serve an important function by providing guidance to IRS personnel and taxpayers in handling routine tax matters.
 - (1) They generally apply retroactively and are binding on the IRS until revoked or modified by subsequent rulings or procedures, Regulations, legislation, or court decisions.
 - (2) They are published weekly by the U.S. Government in the *Internal Revenue Bulletin* (I.R.B.).
 - (3) Revenue Rulings and other tax resources may be found at the IRS website: www.irs.gov.
8. Letter Rulings. A letter ruling is a statement issued by the National Office of the IRS in response to a taxpayer's request, which applies the tax law to a proposed transaction. Revenue rulings can result from a taxpayer request for a letter ruling.

9. Other Administrative Pronouncements.

- a. Treasury Decisions (TDs) are issued by the Treasury Department to announce new Regulations, amend or change existing Regulations, or announce the position of the Government on selected court decisions. TDs are published in the *Internal Revenue Bulletin*.
- b. The IRS also publishes other administrative communications in the *Internal Revenue Bulletin*, such as Announcements, Notices, IRs (News Releases), Internal Legal Memoranda (ILMs), Chief Counsel Notices (CC), and Prohibited Transaction Exemptions
- c. A determination letter is a statement issued by the Area Director in response to a taxpayer and provides guidance on the application of the tax law.
- d. A variety of internal memoranda that constitute the working law of the IRS also are released. These General Counsel Memoranda (GCMs), Technical Advice Memoranda (TAMs), Internal Legal Memoranda (ILMs), and Field Service Advice Memoranda (FSAs) are not officially published, and the IRS indicates that they may not be cited as precedents by taxpayers.
 - (1) Technical Advice Memoranda (TAMs) are furnished by the National Office on a weekly basis. TAMs deal with completed (rather than proposed) transactions. TAMs are issued by the National Office of the IRS in response to questions raised by taxpayers or IRS field personnel during audits.
 - (2) The Office of Chief Counsel prepares Field Service Advice Memoranda (FSAs) to help IRS employees. These are issued in response to requests for advice, guidance, and analysis on difficult or significant tax issues and are not binding on either the taxpayer to whom they pertain or the IRS.
 - (3) Some FSAs are being replaced by another form of field guidance called Technical Expedited Advice Memoranda (TEAMs). The purpose of TEAMs is to expedite legal guidance to field agents as disputes are developing. FSAs are reverting to their original purpose of case-specific development of facts.

Judicial Sources of the Tax Law

10. Five Federal courts have jurisdiction over tax disputes between the IRS and taxpayers: the U.S. Tax Court, the U.S. District Court, the U.S. Court of Federal Claims, the U.S. Court of Appeals, and the U.S. Supreme Court. (See Figure 2-1 at the end of the Lecture Notes for this chapter for the location of Judicial Sources.)
11. The Judicial Process in General. After a taxpayer has exhausted some or all of the remedies available within the IRS, the dispute can be taken to the Federal courts. The

trial and appellate court system for Federal tax litigation is illustrated in Exhibit 2.4 in the text.

- a. A trial court, also known as a court of original jurisdiction, initially hears the case. Appeals (either by the taxpayer or the IRS) are heard by the appropriate appellate court. A taxpayer has a choice of these four trial courts: a Federal District Court, the U.S. Court of Federal Claims, the U.S. Tax Court, or the Small Cases Division of the U.S. Tax Court.
 - b. The Small Cases Division of the U.S. Tax Court hears only cases involving amounts of \$50,000 or less. No appeal available. The broken line between the U.S. Tax Court and the Small Cases Division in Exhibit 2.4 in the text indicates that there is no appeal from the Small Cases Division.
 - (1) This court hears cases involving disputed amounts of \$50,000 or less.
 - (2) Informal proceedings.
 - (a) No necessity for the taxpayer to be represented by a lawyer or other tax adviser.
 - (b) Special trial judges, rather than Tax Court judges, preside over the proceedings.
 - (c) Decisions are not precedent for any other court and are not reviewable by any higher court.
 - c. American law, following English common law, is frequently “made” by judicial decisions. Under the doctrine of *stare decisis*, each decision has precedential value for future decisions with the same controlling set of facts.
 - d. At the trial court level, a taxpayer is normally the plaintiff (or petitioner), and the Government is the defendant (or respondent). If the taxpayer wins and the Government appeals, it becomes the petitioner (or appellant), and the taxpayer becomes the respondent.
12. Trial Courts. (See Concept Summary 2.1 in the text for a summary of various attributes of the Federal trial courts.) The differences among the various trial courts can be summarized as follows:
- Number of courts.
 - Number of judges.
 - Location.
 - Jurisdiction of the Tax Court and District Courts.
 - Jurisdiction of the Court of Federal Claims.
 - Jury trial.
 - Payment of deficiency.

- Appeals.
 - Bankruptcy.
 - Gray areas.
13. Appellate Courts. A trial court decision can be appealed to the appropriate Circuit Court of Appeals. The 11 geographic circuits, the circuit for the District of Columbia, and the Federal Circuit appear in Exhibit 2.5 in the text.
- a. Generally, a three-judge panel hears a Court of Appeals case, but occasionally the full court decides more controversial cases.
 - b. If the Government loses at the trial court level (District Court, Tax Court, or Court of Federal Claims), it may decide not to appeal. However, the fact that the IRS does not appeal does not mean that the IRS agrees with the result.
 - c. The Federal Circuit provides the taxpayer with an alternative forum. When a particular Circuit Court of Appeals has issued an adverse decision in a similar case, the taxpayer may prefer the Court of Federal Claims route, because any appeal is to the Federal Circuit.
14. The Appellate Process. The role of the appellate court is limited to a review of the trial record compiled by the trial court. The appellate process usually involves a determination of whether the trial court applied the proper law in arriving at its decision.
- a. Bound by findings of facts unless they are clearly erroneous.
 - b. The appellate court may approve (affirm) or disapprove (reverse) the lower court's findings, or it may send the case back for further consideration (remand).
 - c. Appellate Precedents and the Tax Court. District Courts, the Tax Court, and the Court of Federal Claims must abide by the precedents set by the Court of Appeals of jurisdiction.
 - d. All courts must follow the decision of the U.S. Supreme Court.
 - e. Since the *Golsen* decision [*Jack E. Golsen*, 54 T.C. 742 (1970)], the Tax Court decides a case as it believes the law should be applied only if the Court of Appeals has not passed on the issue.
 - f. Appeal to the U.S. Supreme Court. The U.S. Supreme Court grants certiorari to resolve a conflict among the Courts of Appeals or where the tax issue is extremely important. The granting of a Writ of Certiorari indicates that at least four of the nine members of the Supreme Court believe that the issue is of sufficient importance to be heard by the full Court.

15. Judicial Citations. Judicial citations usually follow a standard pattern: case name, volume number, reporter series, page or paragraph number, court, and year of the decision (see Concept Summary 2.2 in the text).
- a. Judicial Citations—The U.S. Tax Court. The U.S. Tax Court issues two types of decisions: Regular and Memorandum, based on the Chief Judge’s determination. They differ in both substance and form.
 - (1) Memorandum decisions deal with cases that involve only the application of established principles of law.
 - (2) Regular decisions involve novel issues not previously resolved by the Tax Court.
 - (3) In actual practice, both Regular and Memorandum represent the position of the Tax Court and, as such, can be relied on.
 - (4) Regular Tax Court decisions are published by the U.S. Government Printing Office as the *Tax Court of the United States Reports*. Memorandum decisions are published by both CCH and RIA.
 - (5) If the IRS loses a decision, it may indicate whether it agrees or disagrees with the results reached by the court by publishing an acquiescence (“A” or “Acq.”) or nonacquiescence (“NA” or “Nonacq.”), respectively. The acquiescence or nonacquiescence is published in the *Internal Revenue Bulletin* as an *Action on Decision*.
 - b. Judicial Citations—The U.S. District Court, Court of Federal Claims, and Courts of Appeals. Decisions dealing with Federal tax matters are reported in both the CCH *U.S. Tax Cases* (USTC) and the RIA *American Federal Tax Reports* (AFTR) series. Federal District Court decisions, dealing with both tax and nontax issues, also are published by West in its *Federal Supplement Second Series*.
 - c. Judicial Citations—The U.S. Supreme Court. Decisions are published by CCH in the USTCs and by RIA in the AFTRs. The U.S. Government Printing Office also publishes these decisions in the *United States Supreme Court Reports* (U.S.), as does West in its *Supreme Court Reporter* (S.Ct.), and the Lawyer’s Co-operative Publishing Company in its *United States Reports, Lawyer’s Edition* (L.Ed.).

Other Sources of the Tax Law

16. Tax Treaties. Tax legislation enacted in 1988 provided that neither a tax law nor a tax treaty takes general precedence. If there is a conflict between the Code and a treaty, the most recent item takes precedence.
17. Tax Periodicals. Can shorten the research time needed to resolve a tax issue.

WORKING WITH THE TAX LAW—TAX RESEARCH TOOLS

Commercial Tax Services

18. In the past, commercial tax services could be classified as annotated or topical. However, as tax research has become electronic, this classification system is no longer appropriate. Some of the available commercial tax services include:
 - a. *Standard Federal Tax Reporter*, Commerce Clearing House.
 - b. *CCH IntelliConnect*, Commerce Clearing House. The online version of the *Standard Federal Tax Reporter* (along with other CCH materials).
 - c. *United States Tax Reporter*, Research Institute of America's (RIA), Thomson Reuters.
 - d. Thomson Reuters *Checkpoint*, Research Institute of America. The online versions of RIA's *Federal Tax Coordinator 2d* and *United States Tax Reporter*.
 - e. *Practical Tax Expert*, CCH/Wolters Kluwer.
 - f. *Tax Management Portfolios*, Bloomberg BNA.
 - g. *Mertens Law of Federal Income Taxation*, Thomson Reuters.
 - h. Thomson Reuters *Westlaw* and *WestlawNext*—compilations include access to *Tax Management Portfolios*, *Federal Tax Coordinator 2d*, and *Mertens*.
 - i. LexisNexis *TaxCenter*. A compilation of primary sources and various materials taken from CCH, Matthew Bender, Kleinrock, and Bloomberg BNA.
19. Assessing tax services. In terms of assessing the major tax services, the following points are relevant:
 - a. Except for arrangement of the subject matter, there is not much difference between CCH's *Standard Federal Tax Reporter* and RIA's *United States Tax Reporter*.
 - b. RIA's editorial content is generally more detailed than CCH's editorial content. The RIA editorial materials also contain more detailed tax-planning discussions. However, many practitioners feel that rule coverage and case law background are more extensive in CCH.

- c. Mertens is an excellent source if the emphasis is on background material for in-depth research. Mertens is, however, difficult reading due to its legalistic style. Also, updating is less frequent than most other services and not as accessible.
- d. BNA's *Tax Management Portfolios* (TMPs) comprise a series of monographs on various subjects. As the treatment of a subject usually is exhaustive, a portfolio can serve as a convenient means of familiarizing the reader with the material. Note that portfolios are generally updated on a three-year cycle.
- e. In summary, the day-to-day, all-purpose services are CCH and RIA. Mertens and the TMPs are useful for more extensive research and background.

Using Electronic (Online) Tax Services

- 20. A competent tax professional must become familiar and proficient with electronic research services and be able to use them to complete research projects efficiently.
- 21. Following certain general procedures can simplify the research process. The following suggestions may be helpful:
 - a. Choose keywords for the search carefully.
 - b. Take advantage of connectors.
 - c. Be selective in choosing a database.
 - d. Use a table of contents, index, or citation approach.

Noncommercial Electronic (Online) Tax Services

- 22. The internet provides a wealth of tax information in several popular forms, sometimes at no cost to the researcher.
- 23. A tax professional can access a significant amount of information that can assist in the research process.
 - a. Websites are provided by accounting and consulting firms, publishers, tax academics, libraries, and governmental bodies as a means of making information widely available. One of the best sites available to the tax professional is the Internal Revenue Service's home page, illustrated in Exhibit 2.6 of the text.
 - b. Exhibit 2.7 in the text lists some of the websites that may be most useful to tax researchers. The directory at taxsites.com provides links to accounting and tax sources (including international, state, and payroll tax sources).

- c. Blogs and RSS sites provide a means by which information related to the tax law can be exchanged among taxpayers, tax professionals, and others who subscribe to the group's services.

WORKING WITH THE TAX LAW—TAX RESEARCH

- 24. Tax research is the process of finding a professional conclusion to a tax problem. The problem might originate either from completed or proposed transactions.
- 25. Tax research involves the following procedures (illustrated in Exhibit 2.8 in the text):
 - a. Identifying and refining the problem.
 - b. Locating the appropriate tax law sources.
 - c. Assessing the validity of the tax law sources.
 - d. Arriving at the solution or at alternative solutions with due consideration given to nontax factors.
 - e. Effectively communicating the solution to the taxpayer or the taxpayer's representative.
 - f. Updating the solution in light of new developments.

Identifying the Problem

- 26. Problem identification must start with a compilation of the relevant facts involved. In other words, all the facts that may have a bearing on the problem must be gathered.

Refining the Problem

- 27. Use new facts to refine the tax problem.

Locating the Appropriate Tax Law Sources

- 28. Once the problem is clearly defined, we index the volume of a hard copy tax service or a keyword search on an online tax service.

Assessing the Validity of the Tax Law Sources

- 29. Once a source has been located, the next step is to assess it in light of the problem at hand. Proper assessment involves careful interpretation of the tax law with consideration given to its relevance and validity.

30. Interpreting the Internal Revenue Code. This is the greatest challenge for the IRS. The language of the Code is difficult to comprehend fully.
31. Assessing the Validity of a Treasury Regulation.
- a. Give the Code equal weight when dealing with taxpayers and their representatives.
 - b. Proposed regulations are not binding.
 - c. The burden of proof is on the taxpayer.
 - d. If the taxpayer loses the challenge, then a 20% negligence penalty may be imposed.
 - e. Final regulations can be classified as procedural, interpretive, or legislative. Procedural Regulations are housekeeping-type instructions indicating information that taxpayers should provide the IRS.
 - f. Interpretive regulations are hard and solid and almost impossible to overturn.
 - g. In some Code sections, Congress has given the Treasury Secretary the authority to prescribe Regulations to carry out the details of administration. Regulations issued under this type of authority possess the force and effect of law and are often called legislative Regulations.
 - h. Courts tend to apply the legislative reenactment doctrine.
32. Assessing the Validity of Other Administrative Sources of the Tax Law. In any dispute with the IRS on the interpretation of tax law.
33. Assessing the Validity of Judicial Sources of the Tax Law. How much reliance can be placed on a particular decision depends on the following variables:
- a. The level of court. The higher the level of the court that issued a decision, the greater the weight accorded to that decision.
 - b. Residence of the taxpayer. More reliance is placed on decisions of courts that have jurisdiction in the area where the taxpayer's legal residence is located.
 - c. Regular or Memorandum decision. A Tax Court Regulator decision carries more weight than a memorandum decision, because the Tax Court does not consider memorandum decisions to be binding.
 - d. Supreme Court certiorari. A Circuit Court decision where certiorari has been requested and denied by the U.S. Supreme Court carries more weight than a Circuit Court decision that was not appealed.

- e. Other courts' support. A decision that is supported by cases from other courts carries more weight than a decision that is not supported by other cases.
 - f. Status on appeal. The weight of a decision also can be affected by its status on appeal.
 - g. In connection with the last three variables, the use of a citator is invaluable to tax research. A citator provides the history of a case, including the authority relied on in reaching the result.
34. Assessing the Validity of Other Sources. (See Table 2-1 at the end of the Lecture Notes for this chapter for a list of primary and secondary sources.)
- a. Primary sources of tax law include the Constitution, legislative history materials, statutes, treaties, Treasury Regulations, IRS pronouncements, and judicial decisions.
 - b. Reference to secondary sources such as legal periodicals, treatises, legal opinions, IRS publications, and other materials can be useful. In general, secondary sources are not authority.
 - c. For purposes of the accuracy-related penalty, the IRS expanded the list of substantial authority for purposes of the accuracy-related penalty in § 6662 to include a number of secondary materials.
 - d. A letter ruling or determination letter is substantial authority only for the taxpayer to whom it is issued, except for the accuracy-related penalty.
 - e. Once major tax legislation is completed, the staff of the Joint Committee on Taxation (in consultation with the staffs of the House Ways and Means and Senate Finance Committees) often prepares a General Explanation of the Act, commonly known as the Bluebook.

FINANCIAL DISCLOSURE INSIGHTS

Where Does GAAP Come From? In reconciling the tax and financial accounting reporting of a transaction, the tax professional needs to know the hierarchy of authority of accounting principles—in particular, the level of importance to assign to a specific GAAP document. Discuss the diagram presented in the text which shows the sources of GAAP, arranged in a general order of authority from highest to lowest.

Arriving at the Solution or at Alternative Solutions

35. Discuss possible solutions to The Big Picture questions.

Communicating Tax Research

36. A good tax research communication should tell the audience what was researched, the results of the research, and the justification for the recommendation made. It should contain:
- A clear statement of the issue.
 - A short review of the facts that raise the issue.
 - A review of the pertinent tax law source.
 - Any assumptions made in arriving at the solution.
 - The solution recommended and the logic or reasoning supporting it.
 - The references consulted in the research process.
37. Exhibits 2.9 and 2.10 in the text, present the tax file memos (internal to the firm) and the client letter associated with the facts of The Big Picture.

WORKING WITH THE TAX LAW—TAX PLANNING

38. Tax research and tax planning are inseparable.
- a. The primary purpose of effective tax planning is to reduce the taxpayer's total tax bill.
 - b. The secondary objective of effective tax planning is to reduce or defer the tax in the current tax year.

Nontax Considerations

39. Tax considerations may impair the exercise of sound business judgment by the taxpayer. The goal should be a balance that recognizes the significance of taxes, but not beyond the point where planning detracts from the exercise of good business judgment.

Components of Tax Planning

40. The popular perception of tax planning often is restricted to the adage “defer income and accelerate deductions.” Although this timing approach does hold true and is important, meaningful tax planning involves considerably more.
41. The key components of tax planning include the following:
- a. Avoid the recognition of income.
 - b. Defer the recognition of income.
 - c. Convert the classification of income.
 - d. Choose the business entity with the desired tax attributes.

- e. Preserve formalities by generating and maintaining supporting documentation.
- f. Act in a manner consistent with the intended objective.

Tax Avoidance and Tax Evasion

- 42. Avoidance versus evasion. There is a fine line between legal tax planning and illegal tax planning—tax avoidance versus tax evasion. However, the consequences of the two are as vast as the difference between a lightning bug and lightning.
 - a. Tax avoidance is merely tax minimization through legal techniques. In this sense, tax avoidance becomes the proper objective of all tax planning.
 - b. Evasion, while also aimed at the elimination or reduction of taxes, connotes the use of subterfuge and fraud as a means to an end.

Follow-Up Procedures

- 43. Because tax planning usually involves a proposed transaction, being aware of if or when the law changes is critical to the tax planning process. A change in the tax law could alter the original conclusion. Additional research may be necessary to test the solution in light of current developments. (Refer to the broken lines at the right in Exhibit 2.8 in the text.)

Tax Planning

- 44. Point out that throughout this text, each chapter concludes with observations on Tax Planning.

TAXATION ON THE CPA EXAMINATION

- 45. The CPA exam was revised in 2017. The CPA exam continues to test in the familiar four sections—Auditing and Attestation (AUD), Business Environment and Concepts (BEC), Financial Accounting and Reporting (FAR), and Regulation (REG).
- 46. The exam places less emphasis on remembering and understanding skills, enabling higher-level analysis and evaluation skills to be tested:
 - a. The number of task-based simulations, a highly effective way to assess higher-order skills, increased.
 - b. Total testing time is 16 hours.
 - c. Multiple-choice questions and task-based simulations each contribute about 50% toward the candidate's score in the AUD, FAR, and REG sections. In the BEC

section, multiple-choice questions contribute about 50% of the scoring, with 35% coming from task-based simulations and 15% from written communication.

- d. The revised CPA exam places less emphasis on multiple-choice questions, with about 50% of the total points.
- e. The revised CPA exam tests remembering and understanding, application, analysis, and evaluation. The previous CPA exam only tested for the first two of these items.

Preparation Blueprints

- 47. To prepare for the revised CPA exam, candidates are able to use new AICPA-developed blueprints that replaced the Content Specification Outline (CSO) and Skill Specification Outline (SSO).
- 48. The blueprints provide candidates with more detail about what to expect on the exam and contain about 600 representative tasks.
- 49. The blueprints provide candidates with sample tasks that align with both the content and skill level at which the content will be tested.

Regulation Section

- 50. Taxation continues to be tested within the REG section of the CPA exam. Testing within REG is administered in five blocks called testlets, which feature multiple-choice questions (MCQs) and task-based simulations (TBSs).
- 51. There are five content areas in the REG section of the CPA exam:
 - Area 1: Ethics, professional responsibilities, and Federal tax procedures (weight: 10% to 20%).
 - Area 2: Business law (weight: 10% to 20%).
 - Area 3: Federal taxation of property transactions (weight: 12% to 22%).
 - Area 4: Federal taxation of individuals (weight: 15% to 25%).
 - Area 5: Federal taxation of entities (weight: 28% to 38%).
- 52. Candidates can learn more about the CPA examination at www.cpa-exam.org. This online tutorial site's topics include:
 - Common tools.
 - Navigation.
 - Form completion.
 - Numeric entry.
 - Research questions.
 - Authoritative literature search.
 - Written communication.

Table 2-1
Primary and Secondary Tax Law Sources

	<u>Primary</u>	<u>Secondary</u>
Sixteenth Amendment to Constitution	X	
Tax Treaty	X	
Internal Revenue Code Section	X	
U.S. Supreme Court Decision	X	
U.S. Circuit Court of Appeals Decision	X	
Tax Court Memorandum Decision	X	
Tax Court Regular Decision	X	
U.S. District Court Decision	X	
U.S. Court of Federal Claims Decision	X	
Small Cases Division of U.S. Tax Court	X**	
Final Regulation	X	
Temporary Regulation	X*	
Proposed Regulation	X***	
Revenue Ruling	X	
Revenue Procedure	X	
Senate Finance Committee Report	X	
Bluebook		X
Letter Ruling		X
Technical Advice Memorandum		X
Actions on Decisions		X
Determination Letter		X
<i>Harvard Law Review</i> article		X
Field Service Advice		X
General Counsel Memorandum		X

* Can be outstanding for three years at most.

The categorization of a tax law source as a primary or a secondary source is not black and white. All of the sources categorized as primary in the above table are so categorized because all can be relied on to defend against the application of penalties by the IRS. However, note the following:

** The Tax Court indicates that Small Cases Division opinions should not be used or cited as precedent. As such, these decisions could be categorized as secondary sources.

*** Proposed regulations are not binding. That is, a taxpayer is not required to follow the guidance in the proposed regulation unless (or until) the regulation becomes final. This could lead to the categorization of a proposed regulation as a secondary source.

Figure 2-1
Location of Judicial Sources

	<u>USTC Series</u>	<u>AFTR Series</u>	<u>F.Supp. Series</u>	<u>F.3d Series</u>	<u>Cls.Ct. Series</u>	<u>S.Ct. Series^a</u>
U.S. District Courts (tax cases)	Yes	Yes	Yes	No	No	No
U.S. Tax Court ^b	No ^c	No ^c	No	No	No	No
U.S. Court of Federal Claims ^d (tax cases)	Yes	Yes	No ^e	Yes ^e	Yes ^e	No
U.S. Courts of Appeal (tax cases)	Yes	Yes	No	Yes	No	No
U.S. Supreme Ct. (tax cases)	Yes	Yes	No	No	No	Yes
U.S. District Courts ^f (all cases)	No	No	Yes	No	No	No
U.S. Courts of Appeal (all cases)	No	No	No	Yes	No	No
U.S. Supreme Court (all cases)	No	No	No	No	No	Yes

Notes for Figure 2-1:

- a** Answers also apply to the *United States Supreme Court Reports* (abbreviated U.S.) and to the *United States Reports, Lawyers Edition* (abbreviated L.Ed.).
- b** Regular (not memorandum) decisions are published by the U.S. Government Printing Office (GPO) in *Tax Court of the United States Reports*.
- c** Both CCH and RIA have separate reporters for Regular, Memorandum, and Small Cases Division decisions of the U.S. Tax Court.
- d** All decisions (both tax and nontax) of the U.S. Court of Federal Claims are published by the U.S. GPO in the *Claims Court Reporter Series*. From 1960 to October 1, 1982, Court of Claims decisions were published in the *Court of Claims Reporter Series*.
- e** From 1932 to 1960, the Court of Claims decisions were published in the *F.Supp. Series*. Beginning October 1982, the Claims Court decisions are published in the *Claims Court Reporter*. Beginning on October 30, 1992, the Claims Court underwent a further name change. The new designation, U.S. Court of Federal Claims, begins with Volume 27 of the former *Cl.Ct.* (West citation) now abbreviated as *Fed.Cl.*
- f** “All cases” has reference to nontax as well as tax decisions. Thus, it would include such varied issues as interstate transportation of stolen goods, civil rights violations, and anti-trust suits.

ETHICS AND EQUITY FEATURES

Solutions to Ethics & Equity features are located in the Solutions Manual.

RESEARCH PROBLEMS

Solutions to end-of-chapter Research Problems are located in the Solutions Manual.

IN-CLASS EXERCISES

Q1. The shareholders of Red Corporation and Green Corporation want assurance that the consolidation of both into a single corporation, Blue Corporation, will be a nontaxable reorganization. Should a letter ruling or a determination letter be requested from the IRS? Explain when each is used.

Solution:

The proper approach is to request that the National Office of the IRS issue a letter ruling concerning the income tax effect of the proposed transaction. Letter rulings are issued for a fee upon a taxpayer's request and describe how the IRS will treat a proposed transaction for tax purposes. They apply only to the taxpayer who asks for and obtains the ruling. Letter rulings can be useful to taxpayers who want to be certain of how a transaction will be taxed before proceeding. Letter rulings also allow taxpayers to avoid unexpected tax costs and may be the most effective way to carry out tax planning. However, the IRS limits the issuance of individual rulings to restricted, preannounced areas of taxation.

Determination letters are issued at the request of taxpayers and provide guidance on the application of the tax law. They differ from letter rulings in that the issuing source is an IRS Area Director (rather than the National Office of the IRS). Also, determination letters usually involve completed (as opposed to proposed) transactions.

Q2. During the year, Amy earned \$2,000 working as an independent consultant. She has decided not to declare the income on her return since no 1099s were issued to her. Is this considered tax avoidance or tax evasion?

Solution:

A fine line exists between legal tax planning and illegal tax planning—tax avoidance versus tax evasion. Tax avoidance is merely tax minimization through legal techniques, which is the proper objective of all tax planning. Tax evasion, while also aimed at the elimination or reduction of taxes, connotes the use of subterfuge and fraud as a means to an end. Since Sue has chosen not to report the income on her return, she has committed tax evasion.