



Finding your Way—Thoughts on Efficient Tax Research
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Tax Research and the CPA

This week we'll talk about the concepts we need to worry about when dealing with tax research from a CPA's perspective, including balancing the various issues we face when dealing with compliance work. We'll talk about the various levels of authority presented, as well as the type of research materials available to CPAs and making use of those.

Research and the CPA

Unfortunately, most CPAs had relatively minor undergraduate work in tax research, consisting of a few hours of instruction as one part of a tax class that concentrated fairly heavily on memorizing rules and churning out tax calculations. As well, most of us found that when we first entered the work world that our initial experiences were with producing a significant number of tax returns as a preparer dealing with those above us who seemed to "know the rules" and working in the relatively high pressure and

workload period found during tax season. In that pressure, the key to survival always seemed to be finding “the answer” to the issue on this return as quickly as possible. As well, since our immediate supervisors often were under similar pressure, they tended to just give us the answer rather than explaining the why’s of that answer—it was the fastest way to get this particular return moving forward.

It’s not surprising, then, that for many CPAs bad research habits are developed. The worst of these is believing that tax practice consists of memorizing “the answer” to an infinite number of fact patterns, rather than understanding how to derive an answer to any arbitrary fact pattern that might emerge. Often CPAs, when presented with such material, decide it is “too theoretical” or “not practical” rather than understanding that once mastered good research skills are incredibly practical, saving hours of fruitless searches through an infinite pile of potentially contradictory research materials.

Levels of Authority

The following is going to be basic review for many, to whom I apologize in advance. Some will consider it “too theoretical” and want to skip on to next week’s presentation on a fact specific issue. But some will hopefully find a review of the basics useful, and maybe even enlightening.

Tax law is just that—law. That means the authority is derived, at its base, from the United States Constitution and the constitutions of the various states that are imposing taxes. As you may remember from your high school civics class, the Constitution gives us three branches of government, which I list below along with their most significant components for taxation:

- Legislative—United States Congress
- Executive—Internal Revenue Service
- Judicial—United States Tax Court, United States District Courts, U.S. Court of Claims, Circuit Courts of Appeal, United States Supreme Court

Each of these groups is responsible for a different portion of what we know as the tax law.

Congress and the Internal Revenue Code

The legislative branch gives us the bedrock of the tax law—the Internal Revenue Code, the informal name for Title 26 of the United States Code. Unless the provision of the IRC conflicts with the United States Constitution or a Treaty, the Code represents the ultimate authority on tax issues. Amendments and changes to the IRC can immediately invalidate or significantly modify all of the other sources of authority, overnight rendering what was rock solid support for a position into something of no use whatsoever.

Because it ultimately controls the tax result, it is important to learn how to get back to bedrock Code for any position taken on a return. That's true even of the most mundane issues, like whether the client may claim a particular medical procedure as a medical itemized deduction on Schedule A. While the IRC is, at times, more than slightly obtuse, in other cases it is extraordinarily clear and answers the inquiry immediately.

I have seen CPAs waste hours looking for a “solid answer” to a position, digging through court cases and private letter rulings, to come up empty because, in fact, the answer was so clearly spelled out in the controlling IRC provision that no one has ever bothered to litigate or question the matter in a formal manner. For that reason, the instant you decide you are having trouble with finding an answer, you should retreat to the underlying Code to find the controlling provisions. At best you'll have your answer immediately—and, in any event, you will almost certainly be able to narrow your search to the particular problematic areas of the Code that you hope to find further explained via other means.

The IRS, Regulations, Rulings and the Like

The other branches serve to implement (executive) and interpret (judicial) the law. As I noted, it's important to remember that they are both looking to the law as their starting point, so you have to realize that what you will read is generally going to be written as an interpretation of specific Code sections (again, a good reason to look at the Code).

Regulations are the highest level of authority given by the Internal Revenue Service. They represent the agency's interpretation of the law necessary for implementation and enforcement of the law, and are generally granted a very high level of respect by the courts, who will defer to the IRS's regulatory interpretation in most cases unless it is clearly in conflict with the law.

That said, there are two types of regulations we need to worry about when classifying them in one view—we have interpretative regulations (where the IRS explains what Congress wrote) and legislative regulations (where the IRS is writing what is close to Code). The latter type of regulations are created where Congress has specifically granted authority to the IRS in the law—for instance, in determining the “unforeseen circumstances” available under Section 121 or in establishing qualified private delivery services for the purposes of Section 7502.

While all regulations are granted a high level of deference by the courts, legislative regulations are seen as the ones granting the IRS the most authority to write what they will, since Congress specifically granted that authority as part of the law. That is, the IRS isn't telling us what they think Congress mean when they wrote the law, but rather have been granted the authority to write rules that Congress could have written as law but choose not to, rather giving authority over to the IRS.

Regulations exist in three forms based on whether they have completed the process of public comment and exposure yet. *Final regulations* have run the gamut of comment

periods and hearings, a process that takes time. *Proposed regulations* are drafts of what the IRS has put forward to be eventually adopted as final regulations. Generally, unless the proposed regulation indicates otherwise, they are not considered anything more than a possible interpretation—and maybe an incorrect one. *Temporary regulations* are written to give authoritative guidance during the period before final regulations can be adopted. In many cases, the IRS will issue regulations in identical form as proposed and temporary regulations at the same time, meaning they intend to enforce the positions noted in these regulations immediately even though they have not gone through the entire process. Other times, the IRS will take a less assertive approach and release only proposed regulations and then indicate the “taxpayer may rely” on those regulations pending further guidance.

Revenue Rulings and Revenue Procedures operate at a level below the regulations. They do not go through the same comment process, though they are the official position of the IRS. Generally courts have not allowed the IRS to take contrary positions to Revenue Rulings in court, though taxpayers have been granted more leeway in challenging the conclusions reached. Nevertheless, the courts do take these documents seriously and generally won’t lightly overrule one—and certainly you aren’t going to often get the IRS itself to let go of the position.

Notices, Announcements, etc. are the next level of authority, representing what might be viewed as a “temporary regulation” equivalent in the rulings arena. They are meant to apply to all taxpayers and generally represent the position of the IRS, but they are issued in a less formal manner than Revenue Rulings.

Below this are *Private Letter Rulings* and *Technical Advice Memoranda*. These documents are binding on the IRS only with regard to the particular taxpayer involved, though they offer a useful insight into the thought process of the IRS on many issues—especially in cases where a large number of similar rulings have emerged from the National Office.

Chief Counsel Memoranda and *Service Center Advice* represent internal IRS legal memorandums outlining issues or answers to inquiries. Again they are not considered binding, but do serve to give an insight in how the IRS may view a particular issue.

Forms and Publications are the least authoritative documents, not considered binding on the IRS by the courts except for the purpose of establishing a reasonable cause for avoiding penalties—that is, I prepared my return the way the IRS said to, so they shouldn’t be able to penalize me for negligence when I simply followed their own instructions. But reality is that they do, again, give an insight in how the IRS views an issue (though remember the bias of the author, to quote a line I found years ago in the FAQ to the usenet group misc.taxes—the regular, not the later moderated one. That line may have been one of the few good things ever to come from that group that otherwise became a hangout for tax protestors). And, in some cases, they provide us with the only type of guidance we have.

The Courts—Referee Between Taxpayers and the IRS

When the IRS and taxpayers disagree on the proper application of the law to the facts in a particular case, the courts step in.

In tax practice, the largest number of cases are heard in the special court known as the United States Tax Court, largely because taxpayers can take a case there without first having to pay the tax and then sue for a refund. The United States Tax Court publishes the opinions it writes in cases on a daily basis, giving us a rich source of the application of the law to specific fact patterns that grows constantly.

Tax Court opinions fall into three major categories:

- Regular Tax Court Opinions—these are referred to as “published” opinions, though note that all opinions are “published” now in the nontechnical sense you’d think of normally. However, these cases are considered to deal with new or unique issues of the law and are given precedential value, meaning that if the Tax Court faces the same facts applied to the same law later it will return the same decision unless forced to rule otherwise by a higher court having appellate jurisdiction in the case.

While the District Court and Court of Claims may (and often do) consider Tax Court published opinions in forming their own decisions, they are much more free to go against such a decision, which can create a situation where a taxpayer may decide to pay the tax in order to select a more favorable venue.

- Tax Court Memorandum Opinions—officially these opinions do not create precedent and decide only factual matters that deal with settled areas of the law itself. Reality is that, in fact, courts do tend to pay attention to these decisions and, at times, they do seem to “break ground” on new law positions. For instance, while the original *Strangi* decision was a published opinion (and still valid so far as the issues covered in that decision—remember it was sent back for failure to consider another Code section), the second *Strangi* opinion, which sent panic into the estate planning community, was a memorandum decision.
- Summary Opinions—the small cases, these are not appealable and are not considered precedent. They were the last set of cases that the Tax Court began publishing. These cases are primarily useful to look at the logic of the law applied to a fact situation, but at the moment they do not appear to have “picked up legs” the way Memorandum opinions eventually did, showing up cited in other cases on a regular basis.

Other Courts. As noted, a taxpayer may take his/her case to either the appropriate United States District Court or United States Court of Claims if they pay the tax first. The choice of court is an issue most often decided by the client’s attorney, but is important to note

one quirk of the Court of Claims—that is the one venue where the taxpayer’s appeal would not be heard by his geographic area Court of Appeals, rather ending up in the Federal Circuit. That makes this court the one venue a taxpayer may consider going to if the taxpayer’s own Circuit has ruled in a way contrary to the taxpayer’s position.

Appeals Courts. Except for summary opinion cases, the decisions of the above courts can be appealed to the courts of appeal. The decisions of those courts are binding on the courts below them in their geographic area—and that includes the Tax Court, which has to consider the circuit court that would hear the appeal.

United States Supreme Court. This court gives, if it chooses to, the final answer on how to interpret the law Congress has passed. The court does not have to take any appeal, but rather chooses those which it will hear. In most cases, the Supreme Court only hears cases that have resulted in split decisions in the lower courts in order to resolve the split—but, even if there is a split, there’s no guarantee the court will agree to hear a case that offers the opportunity to resolve that problem.

Research Sources

A CPA who has to find the answer to tax issues have a number of resources they may decide to acquire and turn to. Each one is useful if used properly, and potentially very dangerous if misused.

Quick answer books. A number of “quick answer” books have appeared on the market after the success of the *Quickfinder* series of books for tax professionals. These books give quick reference answers to questions that often arise in a compliance engagement. Sometimes they give a reference to the source of their answer, but they also often give no sources.

These tools are very useful, but you do have to be very aware of their limitations. A key error to avoid involves reading more into the text than is actually there. Remember these books, by their very nature, are interpretative documents, and you have to avoid attempting to read their interpretation as if it were the law that could be interpreted.

One volume tax guides. These guides, such as *CCH’s U.S. Master Tax Guide* or *RIA’s Federal Tax Handbook* generally are meant to provide a one volume reference, but arranged from a more general, and less compliance driven, perspective. They are more likely to cite references for the positions taken in their texts, and generally have references to more detailed guidance in the publisher’s full (and much more expensive) tax services.

Again, it’s important to realize these documents are, by necessity, simplified interpretations of the law and must not, by themselves, be interpreted further.

Tax Services. These multi-volume sets generally try and explain a broad class of tax issues in more detail than is available in a single volume set. They almost always are

heavily footnoted to supporting source materials.

A key issue here is to remember to actually follow up their reference to source materials to assure you agree with their conclusions. They are best viewed as a good, solid outline of the sources to support a position, but again you must be very careful not to interpret their interpretation. When they boil down a thirty page court opinion into a single paragraph, you have to realize that a number of details have been left out.

Source Documents. The answers come from here, and most tax services provide these documents (which are primarily public domain). While they are the source of authoritative answers, remember that you always always have to consider whether what you are looking at is good authority—that is, has the underlying law been changed, the regulation invalidated by the Supreme Court, ruling revoked, etc.

To me the best approach is to have a good set of editorial tools and to then trace their conclusions back to the source documents, as well as confirming my conclusions from source documents with the thoughts of the authors of various editorial services.