

## CHAPTER 2 TAX RESEARCH METHODOLOGY

### DISCUSSION QUESTIONS

- 2-1. The primary purpose of tax research is to aid in finding solutions to tax problems.

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- 2-2. The basic steps in conducting tax research include the following:

**Establish the Facts** This step involves the gathering of facts, including tax and nontax considerations.

**Identify the Issues** The tax researcher must identify both issues of fact and issues of law. In so doing, the researcher must rely on a combination of education, training, and experience.

**Locate the Appropriate Authority** The researcher must locate authority relevant to the client's situation. Authority may include both primary and secondary authority.

**Evaluate the Authority** This step in the tax research process requires the researcher to analyze the authority, including the current status of the authority and the precedential value of the authority.

**Develop Conclusions and Recommendations** The researcher must arrive at his or her conclusions based on the first four steps of the tax research process.

**Communicate the Recommendations** The final step in the research process is to communicate to the client the facts, assumptions, issues, sources of authority, and conclusions and recommendations.

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- 2-3. First, the researcher must understand the mechanical techniques that are used to identify and locate the tax authorities that relate to solving a problem. Second, the researcher must be creative and explore all of the relevant relationships among the facts and the problems at hand.

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- 2-4. Significant tax facts that a tax practitioner might want to obtain could include any of the following:

The client's tax entity(ies).

The client's family status and stability.

The client's past, present, and projected marginal tax rates.

The client's legal domicile and citizenship.

The client's motivation for the transaction.

Relationships among the client and other parties involved in the transaction.

Whether special tax rules apply.

Whether the transaction is proposed or completed.

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2-5. The researcher should be aware of the following pitfalls:

1. The researcher may attempt to research a problem before fully understanding the facts and circumstances relevant to the client's situation.
2. Often the researcher may have a tendency to ignore new questions that arise as the research task progresses.
3. The client may fail to provide all of the information that is vital to an accurate solution.
4. The tax researcher may approach a tax problem without considering other constraints on the solution to the problem, such as economic factors or personal preferences of the client.

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- 2-6. a. T (lower tax liability).  
b. NT (economic constraints).  
c. NT (personal preference).  
d. NT (personal preference).  
e. NT (personal preference).
- 2-7. a. NT (personal preference). Might also be classified as T, since the taxpayer's motivation for a potential transaction is known.  
b. NT (personal preference)  
c. NT (family preference)  
d. T (lower tax liability)  
e. T (lower tax liability)

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- 2-8. Research issues can be divided into two major categories, namely, fact issues and law issues. Fact issues are concerned with problems such as the dates of the transactions, the amounts involved in an exchange, reasonableness, intent, and purpose. Law issues arise when the facts are well established, but it is not clear which portion of the tax law applies.

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- 2-9. The legal concept of *collateral estoppel* bars relitigation on the same facts or the same issues. Therefore, the tax practitioner must be certain that his or her case is researched fully and no issues have been overlooked. If an issue is not addressed in the original case, it may be lost forever.

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- 2-10. Tax research may be spread over a lengthy period of time. The researcher must be aware of changes that occur during this period which might affect the outcome of the research. Applicable law or facts might be subject to changes which will cause the researcher to arrive at different conclusions and recommendations, even concerning completed research activities.

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- 2-11. All tax authority does not carry the same precedential value. The tax researcher must consider the source of the authority, including whether the source of authority is a primary or secondary source, and the force of the authority. Primary authority comes from statutory, administrative, and judicial sources. In fact, statutory authority is the basis for all tax provisions.

Secondary authority consists of unofficial sources of tax information, such as tax journal articles, textbooks, and newsletters. The researcher should be cautious in relying upon secondary authority which does not have precedential value, but which may be of assistance in clarifying or explaining the primary authority. In addition, the researcher must take into account new issues that have developed since the date of the authority.

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- 2-12. Statutory sources include the Constitution, tax treaties, and tax laws that have been passed by Congress. Administrative authority includes the various rulings of the Treasury Department and the IRS. Judicial authority consists of the collected rulings of the various courts on Federal tax matters.

Page 55-56

- 2-13. a. P  
b. P  
c. S  
d. P  
e. P

Pages 55-56

- 2-14. a. P  
b. P  
c. P  
d. S  
e. S

Pages 55-56

- 2-15. a. S  
b. S  
c. P  
d. P  
e. S

Pages 55-56

- 2-16. The annotated tax services are organized in Internal Revenue Code section order. The two major annotated services are published by Commerce Clearing House (CCH) and Research Institute of America (RIA).

The topical services are arranged by topic, as defined by the publisher's editorial staff. The Research

Institute of America (RIA), Commerce Clearing House (CCH), and the Bureau of National Affairs (BNA) all publish major topical tax services.

Page 56

- 2-17. Court reporters are sets of bound volumes in which court decisions are published. Three organizations that produce court reporters are the Government Printing Office, West Publishing Company, and the Research Institute of America (RIA). Commerce Clearing House (CCH) is another example.

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- 2-18. a. CCH  
b. West  
c. RIA (PH may appear on older bound volumes as publisher)  
d. GPO (Government Printing Office)

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- 2-19. A citator is a reference source that enables the researcher to follow the judicial history of court cases.

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- 2-20. The primary publication containing IRS pronouncements is a set of bound volumes titled the *Cumulative Bulletin*.

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- 2-21. A tax service is a coordinated set of reference materials that organizes the tax authority into a useable format, making the Internal Revenue Code more accessible.

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- 2-22. a. *TAXES* - General tax practitioners  
b. *Journal of Taxation* - Sophisticated tax practitioners  
c. *Practical Tax Strategies* – General tax practitioners  
d. *The Tax Adviser* - Members of the AICPA and other tax practitioners

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- 2-23. All tax authority does not carry the same precedential value. In the process of evaluating the tax authority for the issue under consideration, it is possible that new issues, not previously considered, may become known. In this case, the researcher may be required to gather additional facts, find more pertinent authority, and evaluate the new issues. This process is illustrated by the loop in Exhibit 2-1 in the text.

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- 2-24. If a clear solution to a tax research problem has not been obtained, the practitioner must use professional judgment as to the proper conveyance of the research results to the client. In addition, the client might be informed of the alternative possible outcomes of the disputed transaction and give the best acceptable recommendation.

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- 2-25. Include the following items in both the memorandum to the client file and the client letter:
1. A restatement of the pertinent facts from the researcher's perspective.
  2. A summary of any assumptions that the researcher made in the course of his or her research.
  3. A summary of the issues addressed in the research process.
  4. The applicable authority used to arrive at the researcher's conclusions and recommendations.
  5. The researcher's conclusions and recommendations.

Generally, the memorandum to the client file will contain significantly more details than the letter to the client.

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- 2-26. Yes. In many research situations, a fact generates an issue that in turn may lead to an answer or the need for more facts. Similarly, once an answer is found to an issue, it may also cause a new issue to appear or the need to gather more information. The same situation occurs in evaluating authority. Frequently, there will be ambiguity between items of authority that will require the researcher to use his or her critical thinking skills. This may result in new issues becoming known. The researcher would then be required to gather additional facts, find additional pertinent authority, and evaluate the new issues.

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- 2-27. Substantial Authority under Reg. §1.6662-4(d)(3)(iii) includes:
- a. The Internal Revenue Code and other statutory provisions,
  - b. Proposed, Temporary, and Final Regulations,
  - c. Revenue Rulings and Procedures,
  - d. Tax Treaties and regulations there under,
  - e. Court Cases,
  - f. Congressional Committee Reports,
  - g. The Blue Book,
  - h. Private Letter Rulings issued after 10/31/76,
  - i. Technical Advice Memoranda issued after 10/31/76,
  - j. General Counsel Memoranda issued after 3/31/81, and
  - k. IRS Information and Press Releases.

It is important to be familiar with the above sources because any position documented based on these authorities will prevent accuracy-related penalties associated with the item or return under review.

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- 2-28. Online tax research systems provide a fast, cheap method for tax practitioners to access tax information that he or she could not afford to buy before the use of computers. Today's online systems allow the distribution of tax research information and entire tax services to multiple tax staff in both small and large CPA firms. They are accessible through the Internet and several public telecommunications networks. The materials that are available with these services are contained in databases that are stored at centralized computer locations. These databases may be accessed from remote locations with the use of a variety of compatible video devices and keyboards. Usually, they can be accessed via compatible handheld devices and computers that the user already owns.

Advantages of such a system over a standard printed service are the ability on the part of the user to index any significant item by using it as a search item in a query, and the ability for the user to tailor his or her query to fit the requirements of a specific tax problem, which can result in the research process being conducted with greater speed and thoroughness; that online services are updated much faster than printed tax services; that they are particularly useful in researching case law, since every word contained in a case is included in the database, which in turn enables the user to save time by directly accessing only those cases that contain the key terms of his or her search, that certain documents may be obtained only from the central computer library, and that it can be used to obtain regularly published documents to which the researcher does not have access.

## Pages 60- 63

- 2-29. Any of the following could be examples of web addresses of three free online Internet sites where someone could find information on various aspects of taxation:
- [www.willyancey.com](http://www.willyancey.com)
  - <http://taxsites.com>
  - [www.irs.gov](http://www.irs.gov)
  - [www.ey.com](http://www.ey.com)
  - <http://deloitte.com>
  - <http://thomas.loc.gov>

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- 2-30. Computerized tax research involves the utilization of a computerized tax service upon which to conduct tax research. The diligent tax professional must be cognizant of the latest legislative changes and judicial decisions whenever he or she is giving advice to a client. In addition, he or she must be able to draw upon the vast body of established knowledge and to apply certain statutes and administrative and judicial rulings. Since a computerized tax service contains all of the primary sources of the tax law within its database, it is necessary for the tax professional to be able to use the service to conduct research.

When using a computerized tax service, the researcher effectively creates his or her own indices; therefore, he or she is not bound to the limitations imposed by manually accessing tax materials through a printed service or text. In addition, computerized services contain some documents that cannot be located elsewhere.

- 2-31. a. RIA Checkpoint contains all the RIA material on Federal, state, local, and international taxation. Checkpoint contains all RIA analytical material such as the Tax Coordinator 2d and the United States Tax Reporter. All public domain information such as the Code and Regulations, U.S. tax treaties, IRS publications and pronouncements, and court cases are available on Checkpoint.
- b. CCH Tax Research Network contains all of CCH's tax services and other Federal and state legal

and tax information. All government documents (IRS publications, court cases, etc.) are available on this system.

- c. LexisNexis is the largest of the commercial computer-based information systems. Besides containing all Federal and state legal and tax research material, Lexis has extensive libraries of newspapers, magazines, journals, patent records, and medical, economic, and accounting databases.
  - d. Westlaw contains all Federal and state legal sources including court cases, administrative releases, and statutory information. All government documents (IRS publications, court cases, etc.) are also available on this system.
- 2-32. The disadvantages of using a computerized tax service include the high cost of conducting a search and the broad nature of the database.

The database includes all of the pertinent documents needed to conduct a thorough tax research. However, a computerized tax service does not normally include any type of indices; therefore, the researcher must determine the key words to utilize in his or her search request. If the request is not properly structured, the researcher will not locate the pertinent documents.

- 2-33. The major benefits of using a computerized service include the following.
- The primary benefit of using a computerized tax service is that it is possible to index any significant term by using it as a search term in the query. Because the researcher creates his or her own indices, he or she is not bound to the limitations imposed by manually accessing tax materials through a printed service or text.
  - Another benefit of using a computerized tax research system is that the user can tailor his or her query to fit the requirements of a specific tax problem. Because the user defines the precise parameters of his or her query, computerized research is exceptionally flexible.
  - An additional benefit of using a computerized tax service is that certain documents may be obtained only (or only in an affordable format) from the central computer library. For example, printed transcripts of action on decisions and slip opinions normally are not published. However, these documents may be obtained from the databases of both LEXIS and WESTLAW.
  - A computerized research service also can be used to obtain regularly published documents for which the researcher does not have access.
  - Computerized services are updated much faster than are printed tax services.

Pages 60-62

- 2-34. Developing an effective search request requires that the researcher:

1. State the Issue in the Form of a Question
2. Identify the Keywords
3. Construct a Computer Research Query
4. Select Database and Execute Search
5. Interpret and Refine the Search

Pages 63-65

- 2-35. To reduce the number of retrieved documents to a reasonable number, the researcher should modify his or her request, usually by editing the last request transmitted to one that is narrower in scope.

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- 2-36. The RIA search connectors discussed in the text are:
- and – finds documents with both chosen keywords in them
  - or – finds documents with either chosen keywords in them
  - /n - finds documents where the first chosen term is within 'n' words of the second chosen term
  - not – finds documents with the term that precedes the connector, but not the term following the connector

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- 2-37. (1) Primary  
(2) Primary  
(3) Primary  
(4) Secondary

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- 2-38. [www.irs.gov](http://www.irs.gov)

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- 2-39. The connectors used by the IRS web site search engine are (1) “and,” (2) “or,” (3) “not,” and (4) “adj,”

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- 2-40. The two “wildcards” used by the IRS web site search engine are (1) “\*” and (2) “?”. Using these wildcards, you can find documents that contain words that have similar spellings but are not stemmed variants. For example, air\* finds documents that contain air, airline, and airhead. Entering “?at” finds documents that contain cat and hat, while “??at” finds documents that contain that and chat.

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- 2-41. Additional information on searching techniques available for use on the IRS website is available at [www.irs.gov/help/search\\_help.html](http://www.irs.gov/help/search_help.html).

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- 2-42. “Engagement Time Cost” could impact an engagement by making the research too costly for the client.

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- 2-43. The “Potential Tax Liability” in a situation by making the research cost exceed the tax savings.

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- 2-44. The “Accuracy Threshold” could impact how much time is spent on the project. As a general rule, the more accuracy needed by the client, then the more research that needs to be done to reach a higher level of client

comfort.  
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- 2-45. “Professional Ethics” could impact a tax engagement by requiring the researcher to an appropriate comfort level for the research conclusion.

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- 2-46. Uniform CPA Exam parts:

1. Auditing and Attestation: This section covers knowledge of auditing procedures, generally accepted auditing standards and other standards related to attest engagements, and the skills needed to apply that knowledge.
2. Business Environment and Concepts: This section covers knowledge of general business environment and business concepts that candidates need to know in order to understand the underlying business reasons for and accounting implications of business transactions, and the skills needed to apply that knowledge.
3. Financial Accounting and Reporting: This section covers knowledge of generally accepted accounting principles for business enterprises, not-for-profit organizations, and governmental entities, and the skills needed to apply that knowledge.
4. Regulation: This section covers knowledge of Federal taxation, ethics, professional and legal responsibilities, and business law, and the skills needed to apply that knowledge.

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- 2-47. The “supporting skills” that the CPA exam tests are the abilities to communicate, perform research, and analyze information, as well as other higher-order skills such as judgment and understanding.

Answers will vary for the second question.

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- 2-48. The CPA exam “testing period” is the last two months of each calendar quarter. For example, in the first quarter, the testing period is the months of February and March.

- 2-49. Because of the “hands on” Internet nature of this exercise, the answer will vary.

## EXERCISES

- 2-50. The following table summarizes selected tax journals found in most libraries and their target readership:

JOURNAL	PUBLISHER	TARGET READERSHIP
<i>Journal of Taxation</i>	Warren Gorham & Lamont (WG&L) – Thomson Reuters	Sophisticated tax practitioners
<i>Practical Tax Strategies</i>	WG&L – Thomson Reuters	Tax practitioners in general

<i>The Tax Adviser</i>	American Institute of CPAs	Members of AICPA and other tax practitioners
<i>TAXES</i>	Commerce Clearing House	General tax practitioners
<i>Trusts &amp; Estates</i>	Primedia Business Magazines & Media, Inc.	Practitioners who are interested in estates and trusts

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2-51. Call numbers vary from library to library.

Major color of the binding of the publication:

- a. Blue/Black
- b. Black
- c. Light gray
- d. Green

2-52. Solution varies with location.

2-53. Solution varies with location.

2-54. a. Yes, 2 volumes

b. No

c. No

2-55. Generally, the researcher will find:

- a. Rulings and decisions under the Internal Revenue Code
- b. Treaties and Tax Legislation
- c. Administrative, procedural, and miscellaneous announcements
- d. Notices of proposed rule making

2-56. The courts that appear in the AFTR are:

- 1. The Supreme Court
- 2. Court of Appeals
- 3. District Courts
- 4. Claims Court

2-57. The courts that appear in CCH's *US Tax Cases* are:

- 1. The Supreme Court

2. Court of Appeals
  3. District Courts
  4. Claims Court
- 2-58. The CCH citator has two volumes. As of December 1996, the RIA (formerly P-H) citator has five volumes and several annual and monthly supplements.
- 2-59. All responses and answers will vary with the availability of tax research services available for student use on your campus. Information regarding how students can gain access to the system for research projects in your classes should be obtained by the instructor. If the tax research service is not available on your campus, the student will state so.
- 2-60. Because of the “hands on” Internet nature of this exercise, the answer will vary over time.
- 2-61. Because of the “hands on” Internet nature of this exercise, the answer will vary over time.
- 2-62. Because of the “hands on” Internet nature of this exercise, the answer will vary over time.
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- 2-65. Because of the “hands on” Internet nature of this exercise, the answer will vary over time.
- 2-66. Because of the “hands on” Internet nature of this exercise, the answer will vary over time.
- 2-67. a. [www.ftb.ca.gov/](http://www.ftb.ca.gov/)  
b. [www.tax.state.ny.us/](http://www.tax.state.ny.us/)  
c. [www.aicpa.org/index.htm](http://www.aicpa.org/index.htm)
- 2-68. a. [www.state.hi.us/tax/tax.html](http://www.state.hi.us/tax/tax.html)  
b. [www.state.vt.us/tax/index.shtml](http://www.state.vt.us/tax/index.shtml)  
c. [www.atasection.org](http://www.atasection.org)
- Because of the “hands on” Internet nature of this exercise, the answer will vary over time.
- 2-69. a. [www.ador.state.al.us](http://www.ador.state.al.us)  
b. [www.colorado.gov/revenue](http://www.colorado.gov/revenue)  
c. <http://ntanet.org>
- Because of the “hands on” Internet nature of this exercise, the answer will vary over time.
- 2-70. Because of the “hands on” Internet nature of this exercise, the answer will vary over time.
- 2-71. Because of the “hands on” Internet nature of this exercise, the answer will vary over time.

- 2-72. Because of the “hands-on” Internet nature of this exercise, the answer will vary over time.
- 2-73. Because of the “hands-on” Internet nature of this exercise, the answer will vary over time.
- 2-74. a. [www.ey.com](http://www.ey.com)  
b. [www.deloitte.com](http://www.deloitte.com)  
c. [www.bdo.com](http://www.bdo.com)  
d. [www.pwc.com](http://www.pwc.com)
- 2-75. a. New York, NY  
b. Chicago, IL  
c. Cleveland, OH  
d. Seattle, WA
- 2-76. Issues that may be relevant in determining the tax consequences of these transactions include the following:
1. Does the condemnation of the land constitute an involuntary conversion of §1231 property?
  2. If gain is realized, how is it computed?
  3. If gain is recognized, is it ordinary income or capital gain?
  4. Can any of the gain be deferred?
  5. How is the award for damages treated?
- 2-77. Issues that may be relevant in determining the tax consequences of these transactions include the following:
1. Did the accident result from a “willful act” by Joey (i.e., his not setting the brake)?
  2. Does the accident qualify for the casualty loss deduction for Joey?
  3. How are the damages to the car and other property measured?
  4. Are any payments for Nick’s injuries deductible by Joey?
  5. Is the damage to Nick’s house deductible by Joey?
- 2-78. Issues that may be relevant in determining the tax consequences of these transactions include the following:
1. Who has the liability for the tax on the \$75,000, John, Marsha, or both?
  2. Could John and Marsha’s other income have any impact on the taxability of the \$75,000?
  3. Did John receive any benefit from the income and how might that affect any income tax liability?
  4. Do John and Marsha live in a community property or common law state and what impact would that have on any tax liability?

5. If John reimburses the bank for the \$75,000, is it deductible to him?
- 2-79. Issues that may be relevant in determining the tax consequences of these transactions include the following:
1. Is the receipt of the restricted stock compensation to Dave?
  2. Is there any gain realized on the receipt of the stock? If so, how is the gain computed?
  3. If gain is recognized on the receipt of the stock, is it ordinary income or capital gain?
  4. Can any of the gain be deferred? If so, how?
  5. What is Dave's basis in the restricted stock?
  6. If Dave sells the stock after seven years, how will any gain or loss be taxed?
- 2-80. Issues that may be relevant in determining the tax consequences of these transactions include the following.
1. What are the tax consequences of rent received in advance?
  2. Is Ericka a cash or accrual basis taxpayer?
  3. If she is a cash basis taxpayer, how is the rent treated?
  4. If she is an accrual basis taxpayer, how is the rent treated?
  5. How are any expenses (e.g., depreciation and real estate taxes) associated with the rental income treated?
- 2-81. The query should include several of the following key words:
- redemption
  - call
  - proceeds
  - tax-exempt
  - bonds
  - municipal

Examples of queries include the following:

tax-exempt & redemption & call\* (CheckPoint)

tax-exempt and redemption and call! (Lexis)

- 2-82. The query should include several of the following key words:

- treaty
- Germany
- fellowship income
- fellowship grant
- internship

Examples of queries include the following:



3. Does the taxpayer have the burden of proof in determining whether the activity is operated for income or profit?
  4. Does Mr. Manuel have to establish a profit motive for each year that losses are incurred, or once a profit motive is established is this adequate proof for subsequent years?
  5. Is the fact that the activity was conducted on a part-time basis by Mr. Manuel, who was a full-time employee of another entity, indicative that the activity must be a hobby and not a business carried on with intent to earn a profit?
  6. How much of his time does Mr. Manuel spend on this activity?
  7. Does Mr. Manuel invest a significant amount of his money and other resources for the activity?
  8. Does Mr. Manuel advertise and otherwise solicit buyers for his products?
  9. Can Mr. Manuel substantiate the expenditures that he has incurred?
  10. Does Mr. Manuel keep detailed accounting records for the activity separate and apart from his other activities?
  11. Is a reasonable expectation of making a profit required in order to determine whether an activity is a trade or business?
- b. Examples of key words: hobby, business, activity, losses, employee, profit.
- 2-87. a. Issues relevant to the tax treatment of the payment received by the partner include the following:
1. Was the \$125,000 payment received by Matthew Broadway a distribution in liquidation of his partnership interest?
  2. If the payment is a payment in liquidation of Matthew's partnership interest, should the amount be treated as ordinary income or should the amount be treated as received in exchange for his interest in the partnership?
  3. Will the entire payment be subject to the same tax treatment, or should \$45,000 of the payment, representing the settlement of the fee dispute, be treated differently from the remainder of the payment?
  4. Does the partnership use the cash or the accrual basis of accounting for tax purposes?
  5. Under the partnership's method of accounting, when would the fee income be included in the partnership's ordinary income?
  6. Was the fee accounted for in the partnership's prior year return or was the fee included in partnership income only upon settlement of the dispute in the year following the year of receipt?
  7. Does the fact that the fee was placed in an escrow account until the dispute was settled influence the proper time for including the fee in income?
  8. Does the constructive receipt doctrine apply to the partnership?

9. Does the assignment of income doctrine apply in this case to make the fee income taxable to Matthew Broadway, the partner who is withdrawing?
- b. Examples of key words: accrual, cash, accounting, partnership, distribution, constructive receipt.
- 2-88. a. Issues which may be important in determining the allocation of the costs among the lots include:
1. Is the increase in fair market value of improved property indicative of the benefits derived by the property?
  2. What was the taxpayer's purpose behind making the improvements?
  3. Does the taxpayer intend to sell all six of the lots?
  4. Do the street, water, and sewer improvements benefit the three undeveloped lots?
  5. What was the fair market value of each lot immediately after the subdivision, but prior to the improvements?
  6. Are certain of the lots more desirable because of easier access, etc?
  7. Is the relative sales price of each of the three single-family homes relevant for allocating the construction costs?
- b. Examples of key words: improvements, subdividing, real estate, realty, costs.
- 2-89. a. Issues which may be relevant to the tax treatment of the proceeds from the sale of the home include:
1. Can Tom take advantage of the §121 exclusion from the sale of a primary residence?
  2. If Tom's gain is taxable, can he take advantage of the installment sale provisions?
  3. If the property has previously been used for business (i.e. rental or home office) will there be any depreciation recapture?
  4. What is the basis of the old home?
  5. How was title of the old home held by Tom and his wife?
  6. Does the divorce decree specify anything other than a 50/50 split of the residence between Tom and his wife?
- b. Examples of key words: divorce, decree, house, residence, gain, exclusion, occupies, Section 121.
- 2-90. a. Additional information that would be helpful in this situation, based on relevant factors for determining a profit motive as listed in Regulation §1.183-2, includes the following:
1. Does Vinny plan to continue his medical practice while he works on his winery?
  2. If he does plan to continue working at his medical practice, does he plan to continue full-time?

3. How much time and effort are he and/or his family members planning to devote to the winery?
  4. If other family members will be helping with the winery, will they be leaving their occupations to have more time to help out?
  5. Does he plan to carry on the winery endeavor in a business-like manner, keeping books and records, etc.?
  6. Did the taxpayer attempt to acquire knowledge about the winery business or talk to experts in the field?
  7. Is the couple's wealth sufficient to maintain them if future profits don't materialize?
  8. Does Vinny derive little personal or recreational pleasure from this activity?
- b. Additional questions posed to the taxpayer.
- c. No. What Vinny's two children now do for a living is irrelevant.
- d. Will the winery be considered by the IRS to be a bona-fide business with a profit motive or merely a hobby?
- e. Additional research questions might include:
1. Is the taxpayer close to retirement age, and if so, how much will his retirement income be?
  2. How much in losses is the business expected to incur in the start-up years?
  3. What were the start-up costs?
  4. Where did the investment money come from?
  5. What is the tax-entity form of the business?
  6. What is the taxpayer's past, present, and projected marginal tax rates?
  7. Are there special tax rules that apply to the winery business?
- 2-91. a. Additional information that would be helpful in this situation includes the following:
1. Was there any oversight of the accountant by the home office or by a CPA?
  2. What types of internal controls, if any, were in place to prevent the embezzlement?
  3. Was there an audit performed by competent outside auditors?
  4. What system, if any, did the taxpayer have in place to receive and review payroll tax deposits and remittances?
- b. Additional questioning of the taxpayer.
- c. Yes.

- d. Did the taxpayer exercise "ordinary business care and prudence in providing for the payment of its tax liabilities" by establishing oversight of the manager's actions to the extent that, as a result, relief is mandated by the statute, warranting abatement of the penalties due to "reasonable cause"?
  - e. Additional research questions might include:
    - 1. Has the taxpayer already submitted an offer in compromise to the IRS?
    - 2. Have there been any arrangements made for the accountant to repay the embezzled funds?
    - 3. If so, has the taxpayer remitted any funds to the IRS and, if so, how much?
    - 4. Does the taxpayer have an unblemished history of making past payroll tax deposits on time?
- 2-92. a. Additional information that would be helpful in this situation includes the following:
- 1. Is there a divorce decree that calls for the monthly fixed payments of \$12,000?
  - 2. If so, does the divorce decree stipulate what the payments are for?
  - 3. Are there any children involved from the marriage, and if so, is any of the \$12,000 considered provision for child support?
  - 4. Is the taxpayer legally required to continue the monthly payments after death of the ex-spouse?
  - 5. Are the monthly payments being made in cash or property?
- b. Additional questioning of the taxpayer.
- c. The taxpayer's age is not necessarily significant to this issue.
- d. Are tax payments on payments to an ex-spouse deductible?
- d. Additional research questions might include:
- 1. What is the ex-spouse's financial situation, and has it changed significantly since the divorce?
  - 2. Has the ex-spouse since remarried?
  - 3. Was there a pre-nuptial agreement?
  - 4. Have the taxpayer's been living in the same household since the divorce?
- 2-93. a. The primary tax issues involved with this case are as follows.
- 1. Are lottery winnings considered ordinary income or capital gains?
  - 2. What is the basis of a winning lottery ticket?

3. Is the assignment of rights to the winnings to a third party considered constructive receipt of the winnings to the taxpayer?
  4. Is the assignment of rights to a third party considered a capital investment?
- b. Examples of key words:
- lottery
  - installments
  - future
  - investment
  - gross income
  - capital gain
  - lump-sum
  - ordinary income
- 2-94. a. The primary tax issues involved with this case are as follows:
1. Are there any restrictions on starting a business on an Indian Reservation?
  2. Can an Indian tribe be a shareholder in an S corporation?
  3. Is the Indian tribe a Federally recognized tax-exempt organization?
  4. What restrictions are there on tax-exempt organizations in S Corporations?
  5. Is an Indian tribe considered an “individual” for Federal income tax purposes?
- b. Examples of key words:
- Indian tribe
  - individual
  - shareholder
  - S corporation
  - tax-exempt
  - tribal government
  - eligible
- 2-95. a. The primary tax issues involved with this case are as follows:
1. Which, if any, of the seminar expenses qualify as deductible?
  2. Does the location of the seminar and the partial vacation aspect of the trip disqualify the expenditures as deductible?
  3. Is the first class air fare a reasonable expense?
  4. How will the total cost of the trip be allocated between the pleasure and the business portions?
  5. Have the Greens ever been audited by the IRS regarding attendance at seminars? If so, what were the results? Was an agreement entered into which would disallow the current year's deduction?

6. Does Barney or Edith have either a financial or a family relationship with the persons or entity that sponsored the seminar?

b. Examples of key words:

seminar  
investment  
business  
travel  
airfare  
Sec. 274  
Deduction  
meals  
lodging

c. Note to instructor: there are many possible search queries many of which will locate the answer to this case. For example, a proximity query using CheckPoint could be as follows:

seminar /25 investment

This query should return IRS Publications 17, 529, and 550 (among others), all of which state that the investment seminar expenses are not deductible.

2-96. a. 1. Are expenses associated with emotional illnesses considered "medical" expenses?

2. Does Katt need to be claimed as a dependent in order for Ban to be able to take a deduction?

3. Was the special school recommended, or "prescribed," by a doctor?

4. Does the school have special programs which relate specifically to Katt's medical problems?

5. What is Ban's projected medical expense floor and what other medical expenses does Katt anticipate?

6. Are there any provisions in the divorce decree which would impact Ban's right to the deduction?

7. What portion of the expense can be considered "educational" as opposed to "medical"?

b. Examples of key words:

school  
deduction  
medical  
§213  
psychiatrist  
dependent  
emotional illness  
prescription  
special education

c. Note to instructor: there are many possible search queries many of which will locate the

answer to this case. For example, a proximity query using CheckPoint could be as follows.

special /25 school /25 medical

This query should return IRS Publications 3, 17, 502, and 554 (among others), all of which state that the special school medical expenses are deductible (subject to the 7.5% limitation).

2-97. IRC §213 allows a deduction for medical expenses incurred for medical care. Included in this definition are "amounts paid for the cure, treatment, or prevention of disease, or the purpose of affecting any structure or function of the body." Reg. §1.213-1(e)(1)(iii) expands qualifying medical expenses to include any capital expenditures which have, as their primary purpose, the medical care of the taxpayer, his or her spouse, or any dependent. If the capital expenditure results in permanent improvement or betterment of the property and would not ordinarily be for the purpose of medical care, it still may qualify as a medical expense to the extent that the expenditure exceeds the increase in the value of the related property.

a. Consequently, the tax issues involved with the case are as follows:

1. Does a residential swimming pool qualify as a deductible medical expense based on the above definition?
2. Does the tax treatment differ depending on whether the pool is purchased at a new residence or constructed on the taxpayer's existing property?
3. If a residence is purchased that has an existing pool, how is the value of the pool determined for tax purposes?
4. Are pool maintenance expenses deductible and, if so, is any allocation necessary?
5. How is the deduction for the pool taken: as an immediate deduction or depreciated over a specified number of years?
6. Is there a limitation on the deduction based on the elaborateness of the pool?
7. If the home is to be paid for over an extended number of years, would the amount of the deduction be affected?

b. Examples of key words:

swimming  
pool  
medical  
deduction  
§213  
arthritis  
home  
capital expenditure  
costs  
cure  
treatment  
disease

c. Note to instructor: there are many possible search queries many of which will locate the answer to this case. For example, a proximity query using CheckPoint could be as follows:

swimming /25 medical

This query should return IRS Revenue Rulings 83-33, 70-19, and 54-57 (among others). Revenue Ruling 83-33 states that capital costs for swimming pools constructed primarily for medical expenses are deductible (subject to the 7.5% limitation).

2-98. a. Possible tax research issues might include:

1. Would payment of the tax by Gwen constitute financial hardship?
2. Was Gwen involved in taking care of the couple's finances?
3. Was Gwen abused by her ex-spouse?
4. Was there a divorce decree that would cause Darrell to be responsible for making the tax payments?
5. Did Gwen derive benefit from the IRA distribution?

b. Examples of key words:

IRA  
distribution  
medical  
tax liability  
spouse  
divorce  
joint return  
relief  
innocent  
deceit

c. Note to instructor: there are many possible search queries many of which will locate the answer to this case. For example, a proximity query using CheckPoint could be as follows:

"spouse tax liability" and divorce and "joint return"

This query should return Code §6015, which explains that it's possible Gwen could be relieved of the tax liability if she files for relief from joint and several liability on her joint return.

2-99. a. Possible tax research issues might include:

1. Is the money taxable to the Morrises?
2. If it is taxable, is it taxed as ordinary income or capital gains?
3. What year is it taxable, the year found or the year the piano was purchased?

b. Examples of key words:

found  
property

gross income  
taxable  
money

- c. Note to instructor: there are many possible search queries many of which will locate the answer to this case. For example, a proximity query using CheckPoint could be as follows:

found /5 property

This query should return *IRS Pub 17: Part 2 Income or Pub 525 Miscellaneous Income* (among other items). If the Morrises keep the money, it will be taxable income to them in the year they found it.

- 2-100. a. Possible tax research issues might include:

1. Is this a qualified casualty loss?
2. If it is a casualty loss, how much is deductible?
3. What if there is no damage to the taxpayer's property?
4. If it is a casualty loss, when is it deductible?

- b. Examples of key words:

casualty loss  
property  
value  
damage  
itemized deduction

- c. Note to instructor: there are many possible search queries many of which will locate the answer to this case. For example, a proximity query using CheckPoint could be as follows:

Casualty /5 loss

This query should return *IRS Pub 17: Part 5 Standard Deduction and Itemized Deductions* (among other items). Trevor does not have a casualty loss since there was no damage to his property. Losses in value do not qualify as a casualty loss deduction.