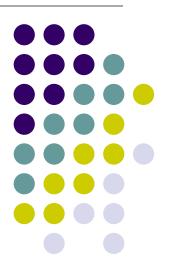
Chapter 2

Tax Compliance, the IRS, and Tax Authorities

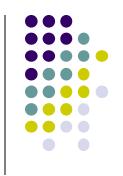






- Identify the filing requirements for income tax returns and the statute of limitations for assessment
- Outline the IRS audit process, how returns are selected, the different types of audits, and what happens after the audit
- Evaluate the relative weights of the various tax law sources
- Describe the legislative process as it pertains to taxation

Learning Objectives (Cont.)



- Perform the basic steps in tax research and evaluate various tax law sources when faced with ambiguous statutes
- Describe tax professional responsibilities in providing tax advice
- Identify taxpayer and tax professional penalties





- Corporations: all must file regardless of taxable income
- Estates and Trusts: required to file if gross income exceeds \$600
- Individuals: filing is determined by taxpayer's filing status, age, and gross income

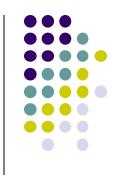
2013 Gross Income Thresholds by Filing Status



EXHIBIT 2-1 2013 Gross Income Thresholds by Filing Status

Filing Status and Age (In 2013)	2013 Gross Income	Explanation
Single	\$10,000	\$6,100 standard deduction + \$3,900 personal exemption
Single, 65 or older	\$11,500	\$6,100 standard deduction + \$1,500 additional deduction + \$3,900 personal exemption
Married, filing a joint return	\$20,000	\$12,200 standard deduction + \$7,800 personal exemptions (2)
Married, filing a joint return, one spouse 65 or older	\$21,200	\$12,200 standard deduction + \$1,200 additional deduction + \$7,800 personal exemptions (2)
Married, filing a joint return, both spouses 65 or older	\$22,400	\$12,200 standard deduction $+$ $$2,400$ additional deductions (2) $+$ $$7,800$ personal exemptions (2)
Married, filing a separate return	\$ 3,900	\$3,900 personal exemption
Head of household	\$12,850	\$8,950 standard deduction + \$3,900 personal exemption
Head of household, 65 or older	\$14,350	\$8,950 standard deduction + \$1,500 additional deduction + \$3,900 personal exemption
Surviving spouse with a dependent child	\$16,100	\$12,200 standard deduction + \$3,900 personal exemption
Surviving spouse, 65 or older, with a dependent child	\$17,300	\$12,200 standard deduction + \$1,200 additional deduction + \$3,900 personal exemption

Tax Return Due Date



- Individuals: 15th day of 4th month following end of tax year.
 - Usually April 15th because individuals are usually on a calendar year.
- Corporations: 15th day of the 3rd month following end of tax year.
- Due dates on a Saturday, Sunday, or holiday are extended to next business day
- Individuals and corporations are allowed to apply for an automatic 6 month extensions





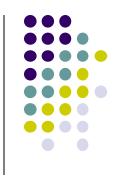
 Corporation XYZ, Inc. has a tax year which ends on August 31st. When will their tax return be due?

November 15th

 Assume they filed an extension, when would the tax return be due?

May 15th





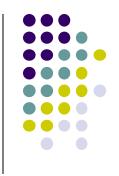
- Often tax returns are filed with incorrect amounts reported either in the taxpayer's favor or the government's favor.
- Statute of limitations: the time in which the taxpayer can file an amended return or the IRS can assess a tax deficiency.
 - Generally ends 3 years from the later of (1) the date the tax return was actually filed, or (2) the tax return's original due date.





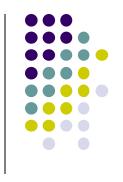
- Bill and Mercedes file their 2009 federal tax return on September 6, 2010 after receiving an automatic extension to file their return by October 15, 2010. When does their statute of limitations end for their 2009 tax return?
 - September 6, 2013 (3 years after the later of the actual filing date and the original due date)

IRS Audit Selection



- In general a taxpayer's return is selected for audit because the IRS believes the tax return has a high probability of being incorrect.
 - IRS uses computer programs to identify tax returns which might have an understated liability.
 - Discriminant Function (DIF) system (scoring system)
 - Document perfection (checks for math errors, etc.)
 - Information matching programs (compares tax return data with other IRS information)

Types of Audits



Correspondence examinations:

- Most common audit
- Conducted by mail and are generally limited to 1 or 2 items on the return

Office examinations:

- Second most common audit
- Conducted in the local IRS office and tends to be broader in scope

• Field examinations:

- Least common audit
- Held at the taxpayer's place of business and can last months to years.

IRS Appeals/Litigation Process

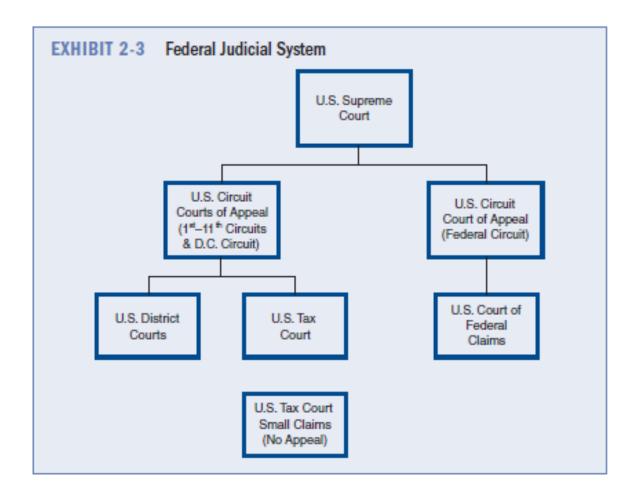


Trial Level Courts



- Tax Court
 - National court; Tax experts; Do not pay tax 1st
- U.S. District Court
 - Local court; Possible jury trial; Generalists; Pay tax 1st
- U.S. Court of Federal Claims
 - National court; Generalists; Pay tax 1st; Appeals to U.S. Circuit Court of Appeals for the Federal Circuit

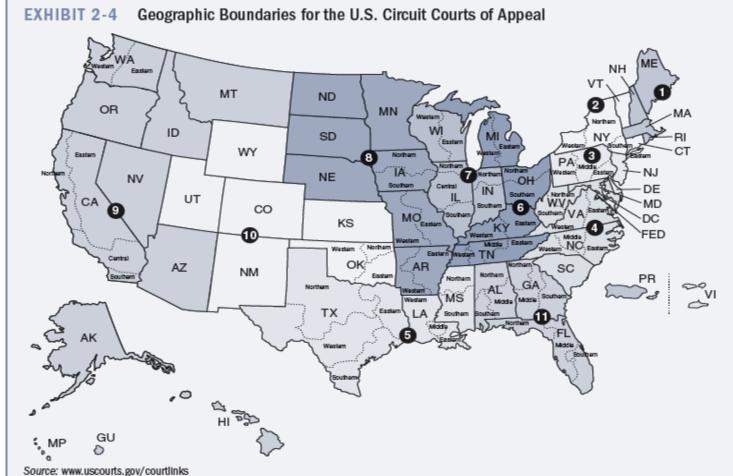
Federal Judicial System





U.S. Circuit Courts of Appeal



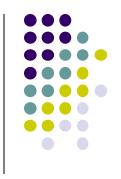


*U.S. District Court jurisdictions for those states with more than one U.S. District Court are also depicted (for example, the state of Washington is divided

**Not depicted are the U.S. Circuit Court of Appeals for the District of Columbia and the U.S. Circuit Court of Appeals for the Federal Circuit.

Into Eastern and Western Districts).

Tax Law Sources



- Primary Authorities: Official sources of tax law
 - Statutory sources (e.g., Internal Revenue Code)
 - Judicial sources (the courts)
 - Administrative sources (IRS pronouncements)
- Secondary Authorities: Unofficial tax authorities
 - Tax services
 - Tax articles

Primary Tax Authorities

EXHIBIT 2-5 Citations to Common Primary Authorities

				-
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Internal Revenue Code

Committee Reports: Senate Finance Committee Report House Ways and Means Committee Report

Administrative Authorities:

Final Regulation

Temporary Regulation Proposed Regulation Revenue Ruling

Revenue Procedure

Private Letter Ruling

Technical Advice Memorandum Judicial Authorities: U.S. Supreme Court

U.S. Circuit Court of Appeals

U.S. Tax Court—Regular decision U.S. Tax Court—Memorandum decision

U.S. Court of Federal Claims

U.S. District Court

Citation:

IRC Sec. 162(e)(2)(B)(I)

S. Rop. No. 353, 82d Cong., 1st Sess. 14 (1951). H. Rop. No. 242, 82d Cong., 1st Sess. 40 (1951)

Citation:

Reg. Sec. 1.217-2(c)(1)

Temp. Reg. Sec. 1.217-2(c)(1) Prop. Reg. Sec. 1.217-2(c)(1) Rev. Rul. 77-262, 1977-2 C.B. 41

Rev. Proc. 99-10, 1999-1 C.B. 272

PLR 200601001

TAM 200402001

Citation:

Comm. v. Kowalski, 434 U.S. 77 (S. Ct., 1977) Comm. v. Kowalski, 98 S. Ct. 315 (S. Ct., 1977)

Comm. v. Kowalski, 77-2 USTC par. 9,748 (S. Ct., 1977) Comm. v. Kowalski, 40 AFTR2d 77-6128 (S. Ct., 1977)

Azar Nut Co. v. Comm., 931 F.2d 314 (5th Cit., 1991) Azar Nut Co. v. Comm., 91-1 USTC

Azer Nut Co. v. Comm., 91-1 USI per. 50,257 (5th Cir., 1991) Azer Nut Co. v. Comm.,

67 AFTR2d 91-987 (5th Cir., 1991) L.A. Beeghly, 36 TC 154 (1962) Robert Rodriguez, RIATC Memo 2005-012

Robert Rodriguez, 85 TCM 1162 (2005)

LR. Cohen v. U.S., 510 F. Supp. 297 (Fed. Cl., 1993) LR. Cohen v. U.S., 72 AFTR2d 93-5124 (Fed. Cl., 1993)

J.R. Cohen v. U.S., 93-1 USIC par. 50,354 (Fed. Cl., 1993) Wasder Towing Co., Inc. v. U.S., 510 E Supp. 297 (W.D, TN, 1981) Wasder Towing Co., Inc. v. U.S., 81-2 USIC par. 9,541 (W.D, TN, 1981)

Waxler Towing Co., Inc. v. U.S., 48 AFTR2d 81-5274 (W.D., TN, 1981)

Explanation:

Section number 162, subsection e, paragraph 2, subparagraph B, clause I Senate report number 353, Congress number 82, Congressional session 1, page number 14, year 1951 House report number 242, Congress number 82, Congressional session 1, page number 40, year 1951

Explanation:

Type of regulation (1 — Income tax), code section 217, regulation number 2, paragraph number c, subparagraph number 1 Same as final regulation

Same as final regulation

Ruling number 77-262 (262nd ruling of 1977), volume number of cumulative bulletin 1977-2, page number 41

Procedure number 99-10 (10th procedure of 1999), volume number of cumulative bulletin 1999-1, page number 272

Year 2006, week number 01 (1st week of 2006), ruling number 001 (1st ruling of the week)

Year 2004, week number 02 (2nd week of 2004), ruling number 001 (1st ruling of the week)

Volume 434 of the GPO court reporter, page 77, year 1977

Volume 98 of the West court reporter, page 315, year 1977

Volume 77-2 of the CCH court reporter, paragraph 9,748,

Volume 40 of the RIA AFTR2d court reporter, paragraph 77-6128,

Volume 931 of the West E2d court reporter, page 314, circuit 5th, year 1991

Volume 91-1 of the CCH USTC court reporter, paragraph 50,257, circuit 5th, year 1991

Volume 67 of the RIA AFTR2d court reporter, paragraph 77-6128, wear 1977

Volume 36 of the Tax Court reporter, page 154, year 1962 Paragraph number 2005-012 of the RIA Tax Court Memorandum

Volume 85 of the CCH Tax Court Memorandum reporter, page 1162, year 2005

Volume 510 of the West E Supp. court reporter, page 297, year 1993

Volume 72 of the RIA AFTR2d court reporter, paragraph 93-5124, year 1993

Volume 93-1 of the CCH USTC court reporter, paragraph 50,354,

Volume 510 of the West F. Supp. court reporter, page 297, Western District (W.D.), state Tennessee, year 1981

Volume 81-2 of the CCH USTC court reporter, paragraph 9,541, Western District (W.D.), state Tennessee, year 1981

Volume 48 of the RIA AFTR2d court reporter, paragraph 81-5274, Western District (W.D.), state Tennessee, year 1981



Secondary Tax Authorities



EXHIBIT 2-6 Common Secondary Tax Authorities

Tax Research Services:

BNA Tax Management Portfolios CCH Standard Federal Tax Reporter CCH Tax Research Consultant RIA Federal Tax Coordinator RIA United States Tax Reporter

Newsletters:

Daily Tax Report Federal Tax Weekly Alert Tax Notes

Law Reviews:

Tax Law Review (New York University School of Law) Virginia Tax Review (University of

Virginia lax Review (University of Virginia School of Law)

Professional Journals:

Journal of Accountancy Journal of Taxation Practical Tax Strategies Taxes Tax Adviser

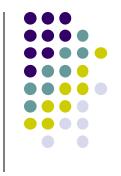
Quick Reference Sources:

IRS Publications CCH MasterTax Guide RIA FederalTax Handbook

Textbooks:

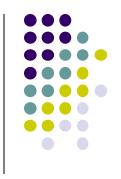
McGraw-Hill's Taxation of Individuals and Business Entities McGraw-Hill's Essentials of Federal Taxation

Tax Sources



- Are the following primary or secondary sources?
 - Internal Revenue Code
 - (Primary)
 - Tax Article in USA Today
 - (Secondary)
 - Article on Supreme Court Opinion
 - (Secondary)
 - Supreme Court Opinion
 - (Primary)
 - RIA Federal Tax Coordinator
 - (Secondary)
 - Treasury Regulations
 - (Primary)

Statutory Authorities



U.S. Constitution

 The 16th Amendment provides Congress the ability to tax income directly, from whatever source derived, without apportionment across the states

Tax Treaties

 agreements negotiated between countries that describe the tax treatment of entities subject to tax in both countries

Statutory Authority: Internal Revenue Code



- The main statutory authority
- Changes enacted by Congress
- Organization of Internal Revenue Code:

Subtitle A – Income Taxes

Chapter 1 – Income Taxes

Subchapter A – Determination of Tax Liability

Part I – Definition of Gross Income, Adjusted Gross Income, Taxable Income, etc. (Sec. 61 – 68)

Sec. 61 - Gross Income Defined

Sec. 62 – Adjusted Gross Income Defined

Sec. 63 - Taxable Income Defined

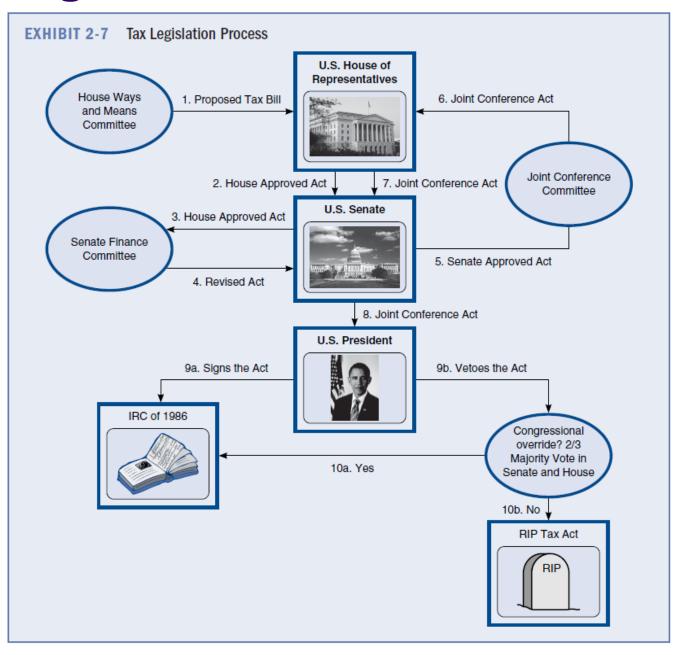
Subsection 63(c) – Standard Deduction

Paragraph 63(c)(2) – Basic Standard Deduction

Subparagraph 63(c)(2)(A) - ...

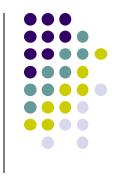
Clause 63(c)(2)(A)(i) - ...

Tax Legislation Process



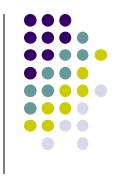






- Tasked with the ultimate authority to interpret the Internal Revenue Code and settle disputes between taxpayers and the IRS
- Supreme Court: the highest judicial authority and is on the same level with the Internal Revenue Code with regard to authority.
- Court of Appeals: 13 Circuit Courts which is the next level of judicial authority

Judicial Sources: The Courts



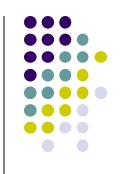
- Trial Level Courts: 3 trial level courts
 - US District Court
 - US Court of Federal Claims
 - US Tax Court
- All courts apply the judicial doctrine of stare decisis, which means that a court will rule consistently with its previous rulings and the rulings of higher courts with appellate jurisdiction. The Tax Court applies the Golsen rule.

Administrative Sources: The US Treasury



- Regulations: Treasury departments official interpretation of the Internal Revenue Code
- 3 Different Forms:
 - Final
 - Temporary
 - Proposed
- 3 Different Purposes:
 - Interpretative
 - Procedural
 - Legislative

Administrative Sources: The US Treasury



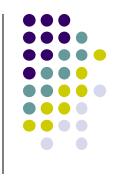
- Revenue Rulings: Less authoritative weight, but they provide a much more detailed interpretation of the Code (e.g., application to a specific factual situation)
- Revenue Procedures: Explain in great detail IRS practice and procedures in administering tax law
- Letter Rulings: Less authoritative but more specific than revenue rulings and regulations (e.g., applied to a specific taxpayer)

Tax Research



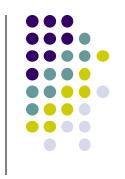
- Step 1: Understand the facts
- Step 2: Identify issues
- Step 3: Locate relevant authorities
- Step 4: Analyze tax authorities
- Step 5: Document and Communicate the results

Tax Research



- Two types of tax services used in tax research
 - Annotated
 - Topical
- Research questions often consist of questions of fact or questions of law
 - The answer to a question of fact hinges upon the facts and circumstances of the taxpayer's transaction
 - The answer to a question of law hinges upon the interpretation of the law, such as, interpreting a particular phrase in a code section

Tax Research

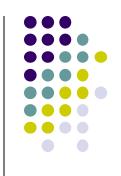


- When the researcher identifies that different authorities have conflicting views, she should evaluate the "hierarchy," jurisdiction, and age of the authorities
- Once the tax researcher has identified relevant authorities, she must make sure that the authorities are still valid and up to date

Tax Memo Layout

- Facts
- Issues
- Authorities
- Conclusion
- Analysis

Client Letter Layout



- Salutation and Social Graces
- Research Question and Limitations
- Facts
- Analysis
- Closing

Tax Professional Responsibilities



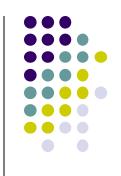
- Tax professionals are subject to various statutes, rules and codes of conduct:
 - AICPA Code of Professional Conduct
 - AICPA Statement on Standards for Tax Services
 - IRS' Circular 230
 - State Board of Accountancy Statutes
- Failure to comply with statutes can result in being admonished, suspended, or barred from practicing

Taxpayer and Tax Practitioner Penalties



- Civil Penalties: most common type of penalties
 - Generally in monetary penalties
 - Imposed when tax practitioners or taxpayers violate tax statutes without reasonable cause
- Criminal Penalties: much less common than civil penalties
 - Penalties are much higher and can include prison sentences

Taxpayer and Tax Practitioner Penalties



- A taxpayer and tax practitioner will not be subject to an underpayment penalty if:
 - there is substantial authority that supports the tax return position or
 - if there is a reasonable basis for the position and it is disclosed on the taxpayer's tax return