

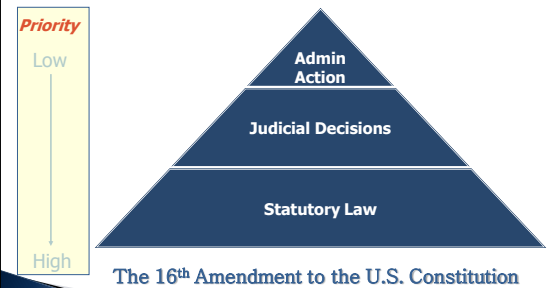
Working with the Tax Law

Chapter 2

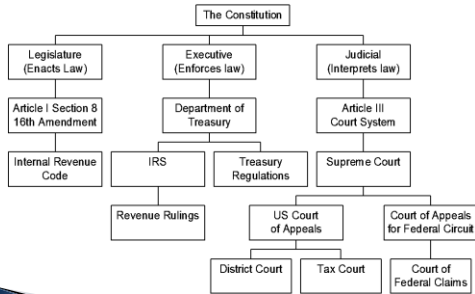
POPULAR SLEEP AIDS



Sources of Tax Law



Sources of Tax Law



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Sources of Tax Law

Source	Authority	Law
Statutory	Congressionally derived law through legislative power provided by the 16 th Amendment to the U.S. Constitution.	Internal Revenue Code of 1986, as amended.
Administrative	<ul style="list-style-type: none"> Treasury Department: Executive authority of law enforcement delegated to the Treasury Department. Internal Revenue Service: Tax collection authority delegated by the Treasury Department to the Internal Revenue Service. 	<ul style="list-style-type: none"> Treasury Regulations: Proposed Regulations, Temporary Regulations, Final Regulations IRS Determinations: Revenue Rulings, Private Letter Rulings, Determination Letters, Revenue Procedures
Judicial	Judicial authority to determine if tax laws enacted by Congress and enforced by the President are constitutional.	Case Law: Usually a case or controversy between a taxpayer and the IRS resulting in case law expressed in the opinion of a court.

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The 16th Amendment

- ▶ Adopted February 25, 1913
- ▶ “The Congress shall have the power to lay and collect taxes on **income, from whatever source derived**, without apportionment among the several States, and without regard to any census or enumeration.”

Happy 99th Birthday!

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The Internal Revenue Code – Statutory Source of Tax Authority

- ▶ Initially created by the Revenue Act of 1913
 - In 1939, the entire federal tax law was codified and entitled the Internal Revenue Code of 1939.
 - In 1954, a new codification of the “Code” was issued.
 - **The present Code is the Internal Revenue Code of 1986, as amended.**

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Organization of the IRC

- ▶ Subtitle
- ▶ Chapters and Subchapters
- ▶ Parts and Subparts
- ▶ Sections and Subsections
- ▶ Paragraphs and Subparagraphs
- ▶ Clauses

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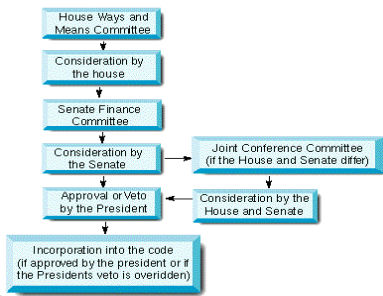
The Legal Impact of the IRC

- ▶ Source of statutory law on taxation
- ▶ Must be adhered to unless a provision is declared unconstitutional
- ▶ Only Congress can amend the Code
- ▶ Ambiguous provisions of the Code are interpreted by the Courts

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How a Bill Becomes Tax Law - The Legislative Process



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Administrative Sources of Tax Law

- ▶ As Chief Executive, the President must enforce the collection of taxes
- ▶ Authority for this function has been delegated to the Treasury Department
- ▶ Administration of the tax system has been delegated by the Treasury to the Internal Revenue Service

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The Treasury's Functions

- ▶ Enact **Regulations**
 - Official Treasury interpretation of the Code
 - To the extent the regulations are consistent with the Code, they have the force and effect of law
- ▶ Issue **Revenue Rulings** and **Private Rulings**
- ▶ Issue **Revenue Procedures**
- ▶ Issue **Determination Letters**
- ▶ **Manage Conflict** with Taxpayers

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Regulations – Stage of Adoption

- ▶ **Proposed**
 - Preview of final regulations
 - Do not have legal precedence
- ▶ **Temporary**
 - Issued when guidance is needed quickly
 - Same authoritative value as final regulations
- ▶ **Final**
 - Have force and effect of law
 - Binding on Taxpayers and Treasury

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Final Regulations

- ▶ **Procedural**
 - Housekeeping instructions
- ▶ **Interpretive**
 - Implement intent of committee reports and code
- ▶ **Legislative**
 - Allows Treasury to determine the details of the law
 - Congress must specifically delegate authority

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Revenue Ruling

- ▶ Based on facts common to many taxpayers
- ▶ Binding on the IRS
- ▶ Taxpayers can:
 - Rely upon the rulings
 - Challenge the rulings in court
- ▶ Courts are not bound by Revenue Rulings
- ▶ Published weekly in the Internal Revenue Bulletin

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Private Ruling (PLR)

- ▶ Issued at the request of the taxpayer
- ▶ The IRS is bound by its determination in the ruling
- ▶ Made available to the public after deletion of certain materials
- ▶ Cannot be relied on by other taxpayers as precedent

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Determination Letters

- ▶ Issued by District Directors for returns filed in their respective districts
- ▶ Must be a completed transaction
- ▶ Issued only if answer is covered specifically by:
 - Statute
 - Treasury decision or regulation
 - Ruling opinion or court decision published in the IRB

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Revenue Procedure

- ▶ Describe internal practices and procedures within the IRS
- ▶ Published in the Internal Revenue Bulletin
- ▶ Generally state changes in techniques and administrative procedures used by the IRS

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Judicial Sources of Tax Law

- ▶ Courts
 - Interpret statutory ambiguity
 - Cannot issue advisory opinions
 - Need “Case or Controversy”
- ▶ Court opinions are binding on lower courts, the IRS, and taxpayers.

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Administration of the Tax System

- ▶ Managed by the Internal Revenue Service (IRS)
- ▶ Important Financial Planning Issues:
 - Statute of Limitations
 - Interest and Penalties
 - Audits
 - Dispute Resolution

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Statute of Limitations

General Statute of Limitations Under Section 6501	3 years
Substantial Omission of Income > 25%	6 years
Fraud	None
Collection of Deficiency by IRS	10 years
Refund Claim by Taxpayer	3 years
Collection of Erroneous Refund	2 years 5 years if induced by fraud
For Refund	3 years from date return is filed, or 2 years from date of payment

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Interest and Penalties

- ▶ **Interest**
 - Accrues from due date of return
 - Paid on refunds if not received within 45 days of filing
- ▶ **Penalties**
 - Failure to file
 - Failure to pay
 - Accuracy related penalty
 - Fraud penalties
 - Underpayment of estimated tax
 - Negligence

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Failure to Pay and Failure to File Penalties

- ▶ **Failure to File**
 - 5% per month or part thereof
 - If fraud, 15%/month
 - Maximum of 25% (5 months)
 - If fraud, 75%
 - If 60 days late, minimum \$100 or amount of tax due
 - Reduced by failure to pay penalty (during 1st 5 months)
- ▶ **Failure to Pay**
 - 0.5% per month or part thereof
 - Maximum of 25% (50 months)

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Taxpayer Noncompliance Penalties Example

Several years ago, Clark failed to file a tax return or pay his taxes. Clark owed \$5,000 in taxes. Clark's tax return and his tax payment are both now 22 months overdue. Clark is subject to a failure to file penalty of \$1,250 (maximum 25% penalty x \$5,000). Clark is also subject to a failure to pay penalty of \$550 (0.5% x 22 months x \$5,000).

Fortunately for Clark, because he is subject to both the failure to file and failure to pay penalties, the first five months of delinquency is subject to the maximum 25% penalty. Thereafter, the \$5,000 unpaid balance is still subject to the 0.5% failure to pay penalty of \$425 (0.5% x 17 months x \$5,000), for a total combined penalty of \$1,675 (\$1,250 + \$425).

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Example (cont.)

Failure to Pay Runs Concurrently with Failure to File for the First 5 Months	
Failure to File 1 st 5 Months (5% x \$5,000)	\$1,250
Failure to Pay 1 st 5 Months (0.5% x \$5,000)	125
Initial Total	\$1,375
Less the Failure to Pay for 1 st 5 Months	(125)
Total for 1 st 5 Months	\$1,250
Failure to Pay Next 17 Months (0.5% x \$5,000)	425
Total Penalty	\$1,675

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Accuracy Related Penalty

- ▶ 20% of underpayment
 - 30% if due to undisclosed listed transactions
- ▶ Causes
 - Failure to make good faith effort to comply with tax law
 - Substantial understatement of tax liability (more than 10% of the correct tax liability)
 - Substantial valuation understatement
 - Substantial estate or gift tax valuation understatement

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Fraud Penalties

- ▶ 75% of underpayment of tax
- ▶ \$500 for frivolous or incomplete tax return
- ▶ May also lead to criminal prosecution
 - Willful failure to file/pay = misdemeanor
 - Penalty up to \$25,000 and 1 year in Jail
 - Willful attempt to evade = felony
 - Penalty up to \$100,000 and 5 years in Jail
 - Willfully makes false return = felony
 - Penalty up to \$100,000 and 3 years in Jail

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Preparer Penalties

- ▶ Procedural
 - Failure to provide copy of return
 - Failure to sign as preparer
 - Failure to keep copy
 - Failure to maintain client list
- ▶ Statutory Penalties
 - Understatement due to unrealistic position
 - Willful attempt to understate tax
 - Failure to exercise due diligence - earned income credit

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Mission of the IRS

Provide America's taxpayers
top quality service
by helping them understand and meet
their tax responsibilities and
enforce the law with integrity and fairness to all.



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Unofficial Position?

- ▶ US Senate hearings – September, 1997
 - IRS employees came forward to testify, hidden behind screens, their voices disguised—afraid, they said, of retaliation. But one agent spoke out boldly, ready to risk her career for what she believed—Jennifer Long from the Houston district of the IRS. She claimed there was an unwritten policy that ...
 - “when reviewing a tax case, it is now our job to stick it to the taxpayer.”

Audits

- ▶ Mismatch of Return & Reporting Documents
- ▶ Discriminate Inventory Function (DIF)
 - Computer matching & Scoring
- ▶ Related party audits
- ▶ Targeted compliance audits
- ▶ Subsequent claims for refund
- ▶ Financial status audits



Audits - 2010

Taxable Returns Examined (in thousands)

Type and Size of Return	Total	Field	Correspondence
Individual Income Tax Returns	44,483	21,010	23,473
Corporation Income Tax Returns (except Form 1120S)	2,782	2,751	31
Estate & Trust Income Tax Returns	461	189	272
Estate Tax Returns	785	785	0
Employment Tax Returns	329	329	0

Math Errors on Tax Returns, 2008

Tax Calculation/Other Taxes	954,853	26.0%
Exemption Number/Amount	573,548	15.6%
Earned Income Tax Credit	578,337	15.8%
Standard/Itemized Deduction	416,270	11.3%
Adjusted Gross/Taxable Income Amount	316,271	8.6%
Child Tax Credit	238,733	6.5%
Refund/Amount Due	198,488	5.4%
Other Credits	86,717	2.4%
Filing Status	97,215	2.7%
Withholding or Excess SS Payments	74,794	2.0%
Adjustments to Income	76,703	2.1%
Other	58,142	1.6%
Total Math Errors	3,670,071	100.0%

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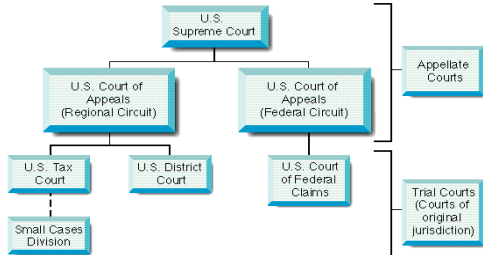
Dispute Resolution Process

- ▶ Examination
- ▶ 30-day letter
 - Taxpayer can appeal to IRS appeals office within 30 days
 - IRS appeals office is separate from examination division
- ▶ If no internal appeal, 90-day letter issued (Notice of deficiency)
 - Taxpayer has 90 days to pay or file petition in tax court, or
 - Pay tax and file suit in District Court or the US Court of Federal Claims.

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The Federal Judicial System



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The U.S. Tax Court

- ▶ No payment of tax is necessary
- ▶ Trial by jury not available
- ▶ Small Tax Case Division – deficiencies up to \$50,000 at the taxpayer’s request
 - Informal procedures; no appeal rights
- ▶ Tax Court decisions do not bind the IRS with respect to other taxpayers
- ▶ Appeals are to the U.S. Court of Appeals

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The U.S. District Court

- ▶ Tax deficiency must be paid in advance
- ▶ Only forum that allows a jury trial
- ▶ Bound by decisions of
 - its Appeals Court, and
 - the U.S. Supreme Court

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The U.S. Court of Federal Claims

- ▶ Sits only in Washington, DC
- ▶ Tax deficiencies must be paid to proceed in this forum
- ▶ Appeal is to the U.S. Court of Appeals for the Federal Circuit

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The U.S. Court of Appeals

- ▶ 12 Circuit Courts
- ▶ Handles appeals from Tax Court and District Court
- ▶ Court of Appeals in one circuit is not bound to follow the decisions of the court of appeals in another circuit

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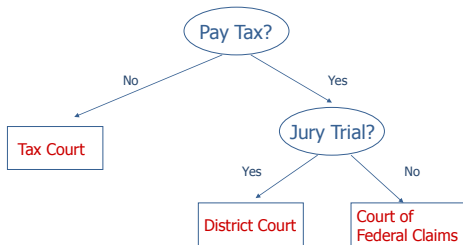
The U.S. Supreme Court

- ▶ Decisions are binding on taxpayers and the IRS
- ▶ Reviews tax cases if:
 - There is a conflict between the circuit courts
 - An important and recurring problem in tax law administration is involved
 - Many taxpayers are involved
 - The decision of a lower court conflicts with long-standing practice or the regulations

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Decision Tree – Forum Shopping



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Court Comparison

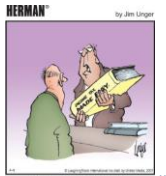
	Tax Court	Tax Court – Small Claims	U.S. District Court	U.S. Court of Federal Claims
Types of Cases	Tax Only	Tax Only	All Types	Claims against U.S. gov't
Required to Pay Tax?	No	No	Yes	Yes
Maximum Claim	N/A	\$50,000	N/A	N/A
Jury Trial?	No	No	Yes	Yes
Court Location	Around U.S.	Around U.S.	Around U.S.	D.C. Only
Appeals to:	U.S. Court of Appeals	No Appeals	U.S. Court of Appeals	U.S. Court of Appeals – Federal Circuit

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Information Available in Basic Tax Research Services

- ▶ Internal Revenue Code (IRC)
- ▶ Treasury Regulations (Treas. Reg.)
- ▶ Practice Aids (offered by RIA, CCH)
 - Quickfinder
- ▶ IRS Manual
- ▶ Court Citations



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Periodicals as a Source of Tax Information

- ▶ Federal Tax Articles (CCH)
- ▶ Journal of Taxation
- ▶ Taxes - The Tax Magazine
- ▶ Tax Notes
- ▶ Monthly Digest of Tax Articles
- ▶ Journal of the Society of Financial Services Professionals
- ▶ Estate Planning
- ▶ Trusts and Estates
- ▶ Journal of Financial Planning

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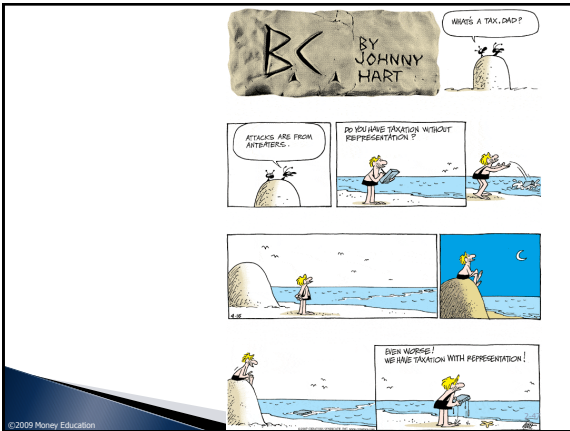
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Keeping Up with New Developments

- ▶ CCH and RIA
- ▶ Accounting Firm Websites
- ▶ www.TaxAlmanac.com
- ▶ *The Daily Tax Report*, published by the Bureau of National Affairs
- ▶ Database Services
- ▶ LEXIS and Westlaw

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