

Tax Research Techniques: Internet Sites and Tools, Methodology, Documentation and Communication of Results

TUESDAY, DECEMBER 17, 2019, 1:00-2:50 pm Eastern

IMPORTANT INFORMATION FOR THE LIVE PROGRAM

This program is approved for 2 CPE credit hours. To earn credit you must:

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Case Study: Tax Research Memo

Facts

- Our client, Hotel Harry, leases a building from a group of investors (Landlord Group) and operates the property as a hotel
- Hotel Harry has sub-leased a space on the roof of the building to a cell phone company (ABC Cell) so they could place a cell tower there
- Hotel Harry collects \$1,000/month from the cell phone company
- There is an active secondary market for cell tower lease payments whereby the Hotel Harry could sell rights to the future payments for a lump sum
- The lease agreement between Hotel Harry and the Landlord Group allows Hotel Harry to keep all the proceeds from this sub-lease. The only requirement is that the Landlord Group gets paid their agreed upon rent from the Hotel Harry.

Issues

1. If Hotel Harry sells his rights to future payments from the cell tower lease, will the character of the income be ordinary or capital?
2. Is there a way to structure the transaction so that the income from the sale is a capital gain?

Analysis

- The substitute for ordinary income doctrine is the idea that receiving a payment now for future ordinary income doesn't constitute the sale of a capital asset. *Womack v Commissioner* explains it this way –
 - “Congress intended ordinary income to be the default tax rate, with capital gains treatment an exception applicable only in appropriate cases. In fact, “the term ‘capital asset’ is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time.” *Comm'r v. Gillette Motor Transp., Inc.*, 364 U.S. 130, 134, 80 S.Ct. 1497, 1500, 4 L.Ed.2d 1617 (1960). This interpretation prevents taxpayers from circumventing ordinary income tax rates by selling rights to future ordinary income payments in exchange for a lump sum. See *Lake*, 356 U.S. at 265, 78 S.Ct. at 694.”
- §1221 defines a capital asset as anything other than inventory, depreciable property used in a trade or business, patents, accounts receivable, US

government publications, derivatives, hedging transactions, and business supplies

- This means a lease is not a capital asset because it's subject to depreciation if you incurred lease acquisition costs
- §1222 provides that a capital gain is the gain from the sale or exchange of a capital asset
- §1241 provides that amounts received by a lessee for the cancellation of a lease are considered amounts received in exchange for the lease
- §1.1241-1(a) provides that the regulation does not determine if a lease is a capital asset
- §1231(a)(1) provides that §1231 gains are long-term capital gains
- §1231(a)(3)(A) defines §1231 gains as –
 - Any recognized gain from the sale or exchange of property used in a trade or business
- §1231(b)(1) defines “property used in the trade or business” as including real property used in the trade or business
- Revenue Ruling 72-85 provides that a leasehold of property used in a trade or business is §1231 property.
 - It says leaseholds can be property of a character which is subject to depreciation under §167 and cites several court cases

Conclusion

Simply receiving a lump-sum payment for assigning future rent payments of the cell tower would be considered ordinary income under the “substitute for ordinary income doctrine”.

To achieve capital gain treatment there needs to be the sale or exchange of a capital asset or gain on the sale of a §1231 asset.

Gain on the sale of a §1231 asset could be achieved in the following steps –

1. The purchaser of the cell tower payments pays a lump sum to Hotel Harry in exchange for the lease rights to the space on the roof holding the cell tower.
2. The purchaser then executes a lease with the Landlord Group for no monthly cost.

This works because Hotel Harry is selling his lease rights, which are considered a §1231 asset and the gain from the sale of a §1231 asset is a long-term capital gain.

Tax Research Memos & Files

Tax professionals often must document and communicate their tax research. Clear written communication is important since both tax planning opportunities and governmental audits can cause prior tax returns to be amended. Without the documentation, a tax professional may have long since forgotten the reasons for his or her research conclusions. In some cases, the tax professionals who prepared the research memo may no longer be with the firm, increasing the importance of written communication that others can follow easily. The tax memo addresses the relevant tax authorities and rationales which must be thoroughly documented and clearly explained for the client's particular fact pattern.

Tax professionals do not universally use the same techniques. Generally, the more time taken to prepare a research memo, the less time necessary to review it. The methodology that is appropriate for your situation will vary driven by the difference in compensation rates between the memos reviewer and preparer. The following method is biased toward the ease of review and, thus, is more appropriate for multi-member firms.

A quality tax research memo is the result of thorough research, careful interpretation of the tax authority located, application of the tax authority to the client's facts, and clear communication of the research analysis and conclusions.

Organize the Research Memo

Tax research memos should contain features allowing reviewers to read and understand their contents quickly. Organization is the key ingredient.

The research memo contains two parts: (1) the main text and (2) authoritative support materials. The main text is the portion the researcher writes and consists of facts, issues, conclusions, and analyses. The support materials, which are essentially attachments, are primary sources of the tax law (e.g., Code, regulations, judicial decisions, and rulings).

Support material should be arranged in order of authoritative weight. For example, the relevant Code sections should appear first (in Code section order), followed by regulations (also in Code section order). After the last regulation, all judicial decisions should appear (highest courts first and most recent dates first within each court), followed by all revenue rulings cited (most recent rulings first). Organizing the authoritative support in this logical order allows the reviewer to locate a particular source quickly, especially when the reviewer wishes to check for or review authoritative support before the main text.

For example, the reviewer may know that a particular court case is relevant to the research and wish to check whether the memo's preparer consulted this decision before reading the entire memo. Listing authoritative support in a logical order mitigates the desirability or necessity to include a table of contents or similar guide to the support materials in the Authority section of your research file, especially when this section is lengthy.

Clearly State the Facts

“Facts Section” – Begin with a complete statement of the facts. Material facts should not be introduced in the technical analysis portion of the memo. Careless or ambiguous statements of facts or omitted facts can lead to inefficient research or, worse, inappropriate conclusions. Clearly stating facts is particularly important when more than one person is involved in the research project. For example, the person who began the research might leave the firm before finishing. The facts should be written clearly so that whoever continues the research project (or deals with the issues in a later IRS audit) will understand them with virtually no chance of misinterpretation. When research is based on misconceptions or incorrect facts, part or all of the research often must be redone. Depending on the situation, the tax professional may bear the cost of these mistakes and resulting inefficiencies.

Facts often are gathered at different times and through different means. For example, facts might be obtained initially through a face-to-face meeting with the client. After the research has begun, the tax professional may realize the need for additional facts or clarifications, which might be obtained through a follow-up telephone conversation, e-mail correspondence, or a formal letter.

Documents containing relevant facts (e.g., contracts, court orders, and hand-written notes) can be incorporated through cross-reference and as attachments to the research memo (in a third section behind the authority).

Express Issues Clearly and Conclusions Early

“Issue Section”: As with the Facts section, the tax professional should express all issues clearly and unambiguously; that is, the meaning of issues should be subject to only one possible interpretation. When the issue is written unclearly or ambiguously, the tax professional may research the wrong issue. Or, the reviewer may be uncertain about the issue and whether the correct issue was researched.

Number and arrange issues in the most logical order. Generally, important issues should be addressed first, but avoid the temptation to separately list numerous obscure and irrelevant issues. Some issues cannot be addressed until other issues are resolved first. To maintain a logical progression, dependent issues should follow precedent issues.

Issues should be written in question form. Issues do not need to be structured as “yes” or “no” questions. In contrast to issues within judicial briefs, research memo issues should be couched in the specific context of the client’s facts. Compare the level of specificity in the following two issue statements:

- A) How much can a taxpayer deduct for money donated to her church last year? (*VAGUE*)
- B) How much of the \$60,000 Judy Smith donated to the First Universal Church in 2018 can she deduct? (*SPECIFIC*)

A common mistake is to emphasize financial accounting concepts, such as net income and expense, rather than the analogous tax concepts, namely gross income and deduction. In the first example, the issue is a non-tax matter (how to report a payment for financial statement purposes):

- A) Can Black Co. expense the rental payment to its chief financial officer? (*GAAP*)
- B) Can Black Co. deduct the rental payment to its chief financial officer? (*TAX*)

Provide sufficient detail so that the issue's tax implication is clear but avoid including a detailed cite within the issue. Express issues in the context of major tax concepts like gross income, capital gain, exclusion, deduction, credit, and basis. Consider these two examples:

- A) What is the tax treatment for a company under Reg. Sec. 1.162-5(c)(1) when it pays an employee's tuition?
- B) Can White Co. deduct the \$5,600 it pays to Jan Smith, HR Manager, to cover her tuition?

“Conclusion Section” - Immediately after each issue, give a clear and unambiguous conclusion in a separate sentence. Research memos are easier to read when the reviewer knows from the outset where the analysis will end.

“Discussion Section” – The presentation of research findings and conclusions should not resemble a mystery novel. By presenting the conclusion early, you did not make the reviewer wade through the entire analysis before revealing the conclusion. Use the Discussion Section to logically and methodically explain how you arrived at your conclusion.

Apply Tax Law to Facts

Applying the tax law to a client's facts involves two distinct steps. First, discuss tax authority in sufficient detail to show its relationship to the client's situation. Second, build a “bridge” that logically connects each cited authority with the facts. You should not simply refer the reviewer to your source. Do not force the reviewer to interpret the tax authority, wonder how your cited authority relates to the issue, or otherwise guess your line of reasoning. Make it so clear that misinterpretation is impossible.

Cite Tax Authority

Documentation is a very important part of communicating the results of tax research. Unsupported statements or opinions are worthless to the reader who desires to verify your findings. Supporting cites should be to primary sources, except in rare, unusual situations.

In tax research, reviewers understand statutory cites to be references to the Internal Revenue Code and regulatory cites to be references to Treasury Regulations. The tax professional should provide complete and specific citations:

- Sec. 864(c)(4)(C) not Sec. 864
- Reg. Sec. 1.162-1(a)(2) not Reg. 1.161-1

Cites to judicial decisions should include only the title, court and year of the decision. The volumes and page numbers do not convey information about the legal weight and just clutter the analysis. Because the authoritative support is included in a separate section of the Research file, the reviewer can access the materials as needed.

Abbreviate very common tax terms as appropriate, especially in cites. Thus, use Reg. rather than Regulation or Treasury Regulation, Rev. Rul. rather than Revenue Ruling, CIR or Comm. in judicial citations rather than Commissioner or Commissioner of Internal Revenue, IRS rather than Internal Revenue Service, Code or IRC rather than Internal Revenue Code, and U.S. rather than United States.

Attach Tax Authority

Attaching copies of tax authorities takes time but save the reviewer time.

Generally, the authority should include the full text of any Code Section, regulation, ruling or judicial decision cited. If you cite 195(a), the entire Section 195 would be included in the file. Similarly, if you cite Reg. Section 1.61-2(a)(1) – you would include all of Reg. Section 1.61-2 in your support materials and not just the page that includes the specific cite.

Including the full materials allows the reviewer to see your citation in context and also review for potential “misreads” or exceptions that might disqualify the taxpayer. Reviewers sometimes do not have ready or convenient access to authoritative support. Even when reviewers can be assumed to have ready access, it is important to direct the reviewer to the exact passage on the correct page that is relevant. Unless the researcher and the reviewer are using the same research materials, even a page reference will not necessarily lead the reviewer to the correct page of a referenced source because the paging system may differ.

Some firms include cross-references in paper files. When an authority is cited in your main text, a cross reference is included in the right-hand margin noting the page number from the Authority section. Similarly, in the Authority section, the reference to the main text page number is added next to the pertinent data. Don’t reference the title to a judicial decision or other authority – but add the reference close to the specific text that supports your conclusion. Another time saver is to highlight the relevant section within the full text draw the reviewer directly to the pertinent passage. Try to narrow the highlight down to one or two sentences as the reviewer can always read for context.

Commercial Tax Research Resources
As of November 2019

“Premium” Priced (but may offer multiple pricing options)

Bloomberg Tax

www.bna.com/tax

<https://pro.bloombergtax.com/>

CCH AnswerConnect

www.answerconnect.cch.com

CCH Intelliconnect

<https://taxna.wolterskluwer.com/research/intelliconnect>

www.cchgroup.com

Checkpoint

<https://checkpoint.riag.com/>

<https://tax.thomsonreuters.com/en/checkpoint>

LexisNexis

www.lexisnexis.com

Tax Analysts

www.taxnotes.com

Economy Priced

Parker Tax Pro Library

www.parkertaxpublishing.com

The Tax Book

www.thetaxbook.com

Comparisons:

“The Best Tax Software 2019: Annual Survey of New York State Practitioners”

Published in The CPA Journal (November 2019) by Susan B. Anders and Carol M. Fischer

<https://www.cpajournal.com/2019/11/26/the-best-tax-software-2019/>

“Tax Research Software: More Relevant Than Ever”

Published in AccountingToday (October 5, 2018) by Ted Needleman

<https://www.accountingtoday.com/news/tax-research-software-more-relevant-than-ever>

Free Tax Research Resources
As of November 2019

U.S. Federal Government

Congress.gov

www.congress.gov

Includes searchable legislative resources including enacted legislation, committee reports, and treaties. The site is generally updated the morning after a session adjourns.

Internal Revenue Service

www.irs.gov/

Includes searchable forms, instructions, publications, and other IRS information.

Internal Revenue Service, Internal Revenue Bulletins

<https://www.irs.gov/irb>

IRBs in html and pdf format

Law Library of Congress

<http://www.loc.gov/law/index.php>

Includes federal and international legal resources

U.S. Code

<https://uscode.house.gov/>

Provided by the Office of the Law Revision Counsel of the U.S. House of Representatives

U.S. Department of State, Treaties in Force

<https://www.state.gov/treaties-in-force/>

Information on treaties and other international agreements

U.S. Government Publishing Office (GPO)

<https://www.gpo.gov/>

Official federal government publications and information products from Congress and federal agencies.

U.S. Tax Court

<https://www.ustaxcourt.gov/>

Includes T.C. and TC Memo cases from September 25, 1995, and TC Summary cases since January 10, 2001.

Other Sources

Cornell Law School/Legal Information Institute

<https://www.law.cornell.edu/uscode/text/26>

Includes tax and other general law documents including the Constitution, Supreme Court cases, and the U.S. Code (including the IRC) and links to a variety of state and international sources.

Findlaw

<https://caselaw.findlaw.com/>

Includes links for state and federal laws and a searchable database of summaries of published opinions from selected federal and state courts back to 2000.

Google Scholar

www.scholar.google.com/

Includes federal and state court cases including tax.

Justia

www.law.justia.com/

Includes federal and state case law (but not Tax Court cases), U.S. and state codes, and federal regulations.

Leagle

www.leagle.com/

Includes primary case law from all federal courts and all state higher courts. Updated within 24 hours.

Legalbitstream

www.legalbitstream.com/

Includes tax cases (since 1990 in most cases), Treasury and IRS materials, and legislative sources in searchable database. The database is generally updated within one or two weeks after material is made public.

NYU GlobaLex

www.nyulawglobal.org

Focus is on international and foreign law research including tax.

Public Library of Law

www.plol.org/Pages/Search.aspx

Includes federal cases from the Supreme Court and Courts of Appeals, state cases back to 1997, and federal and state statutory law and regulations.

TaxSearch.org

<https://www.taxsearch.org/>

Formerly GlobalTaxLaws.com (Google Tax Research). A tax focused search engine that uses Google search functions.

Professional Resources

IRS Tax Professionals Web Page

A central landing page for a variety of IRS resources

<https://www.irs.gov/tax-professionals>

IRS Circular 230

<https://www.aicpa.org/interestareas/tax/resources/standardsethics/treasurydepartmentcircularno230.html>

AICPA Tax Section Home Page

A library of AICPA resources and tools—many are limited to Tax Section members

<https://www.aicpa.org/interestareas/tax.html>

AICPA U.S. Federal Tax Law Hierarchy Quick Reference Chart:

<https://www.aicpa.org/content/dam/aicpa/interestareas/tax/resources/practicemanagement/downloadabledocuments/u-s-federal-tax-law-hierarchy-quick-reference-chart.pdf>

AICPA Code of Professional Conduct

<https://www.aicpa.org/research/standards/codeofconduct.html>

AICPA Statements on Standards for Tax Services

<https://www.aicpa.org/interestareas/tax/resources/standardsethics/statementsonstandardsfortaxservices.html>