

# Constitutional and Legislative Sources

## Chapter Outline

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Sources of Federal Tax Law

History of U.S. Taxation

U.S. Constitution

Tax Treaties

The Legislative Process

Where to Find Committee Reports

Internal Revenue Code

Organization of the Internal Revenue Code

Where to Find the Internal Revenue Code

Interpreting the Internal Revenue Code

## Learning Objectives

- Outline the primary and secondary sources of the Federal tax law.
- Describe in detail the nature and structure of the statutory sources of the tax law, including the Constitution, tax treaties, and the Internal Revenue Code.
- Delineate how statutory tax law is created and how tax research resources are generated in this process.
- Determine how to locate the statutory sources of the tax law.
- Discuss how the tax researcher can carefully interpret the Internal Revenue Code.

QUESTIONS ABOUT INCOME TAXATION, unlike many other areas of law, are primarily based in the underlying statute. As a result, the first step in locating potential authority in a tax matter usually consists of identifying the pertinent Code section(s). The current statutory source is in the *Internal Revenue Code (IRC)* of 1986. In addition, a tax researcher may need to examine the legislative history of a tax provision. Furthermore, it may be necessary to understand the constitutional foundation and associated tax treaties that may affect the Code section(s) in question.

In this chapter, we take a closer look at the tax research process and how the primary tax law sources are used to help the tax researcher arrive at a solution to his or her client's tax problems.

Tax professionals utilize three primary sources of the tax law, mirroring the constitutional division of the function of the Federal government.

- Statutory sources, or the legislative branch.
- Administrative sources, or the executive branch.
- Judicial sources, or the judicial branch.

Thus, the constitutional and legislative tax sources often are referred to as the “**statutory sources.**”

## SOURCES OF FEDERAL TAX LAW

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As mentioned in the previous chapter, the sources of the Federal tax law can be classified as **primary authorities** or **secondary authorities**. Chapters 3 through 8 of this text include detailed examinations of these various sources, discussing their nature, location, and use in the tax research process. The sources of the Federal tax law to be examined here are presented in outline form in Exhibit 3-1. In particular, we will examine the statutory sources of the U.S. Constitution, tax treaties, and the *Internal Revenue Code*. The reader should refer to this outline while reading this text to maintain perspective as to the relationships between each of the sources discussed.

## HISTORY OF U.S. TAXATION

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Although the Massachusetts Bay Colony enacted an income tax law in 1643, the first U.S. income tax was not created until the Civil War. An income tax law was passed at that time to help the North pay for the cost of fighting the war. This Federal income tax law was passed on August 5, 1861. The tax was not generally enforced, but some limited collections were made under the law.

This first Federal income tax was levied at the rate of a modest 3 percent on income between \$600 and \$10,000, and 5 percent on marginal incomes in excess of \$10,000. Later, in 1867, the rate was a flat 5 percent of income in excess of \$1,000. The Civil War income taxes were allowed to expire in 1872. In 1894 another income tax act was passed by Congress. By this time, however, the income tax had become an important political issue. The southern and western states generally favored the tax, and the eastern states generally opposed it—the tax had developed into an important element of the Populist political movement. In *Pollock v. Farmers' Loan and Trust Co.*, 157 U.S. 429, 15 S.Ct. 673 (1895), the Supreme Court held that the income tax was unconstitutional because it was a constitutionally prohibited “direct tax.”

**Exhibit 3-1: Framework of Primary and Secondary Sources of Federal Tax Law**

<b>Primary Sources (Original Pronouncements)</b>	<b>Secondary Sources (Interpretations of Primary Authority)</b>
<b>Statutory Sources (Chapter 3)</b>	
U.S. Constitution	<b>(Chapters 6–8)</b>
Tax Treaties	
<i>Internal Revenue Code</i>	<b>Tax Services</b>
<b>Administrative Sources (Chapter 4)</b>	<i>Annotated Services</i>
Treasury Regulations	<i>Topical Services</i>
Revenue Rulings	
Revenue Procedures	<b>Tax Citators</b>
Other written determinations	
Miscellaneous IRS publications	<b>Tax Journals</b>
<b>Judicial Sources (Chapter 5)</b>	
Supreme Court	<b>Tax Newsletters</b>
Courts of Appeals	
District Courts	<b>Tax Textbooks</b>
U.S. Court of Federal Claims	
Tax Court	<b>Tax Treatises</b>
Tax Court, Small Cases Division	

The supporters of the income tax decided to amend the Constitution so that there would be no question as to the constitutionality of a Federal income tax, applying progressive rates to diverse sources of income. The proposed amendment was sent to the states on July 12, 1909, by the Sixty-First Congress; it was ratified on February 3, 1913. The new Sixteenth Amendment to the Constitution stated:

*The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.*

A copy of a 1913 individual tax return (Form 1040) is shown in Exhibit 3-2. It should be noted that individual taxpayers were allowed a \$3,000 (\$4,000 for married taxpayers) “specific exemption” before they had to start paying income tax at a 1 percent rate. The 1 percent bracket went up to \$20,000 of taxable income before a surtax of an additional 1 percent was added. The surtax eventually reached 6 percent at a taxable income of \$500,000. Thus, the maximum marginal tax rate in 1913 was 7 percent (1% regular tax plus 6% surtax).

The 1913 specific exemption is similar to the current standard deduction. If \$3,000 in 1913 were price-level adjusted into today’s dollars, it would be more than \$63,000. Thus, an individual taxpayer would not pay any Federal income tax until he or she showed taxable income of over \$63,000 if an equivalent exemption were in place today.

Before the Sixteenth Amendment was ratified, Congress passed a corporate income tax in 1909. This tax also was challenged at the Supreme Court level, in *Flint v. Stone Tracy Co.* 220 U.S. 107, 31 S.Ct. 342 (1911). The Court held that this tax was constitutional because it was a special form of excise tax on the privilege of operating in the corporate form, using income as its base, rather than a (prohibited) direct income tax.

**Exhibit 3-2: 1913 Individual Form 1040**

TO BE FILLED IN BY COLLECTOR. Form 1040. TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

List No. \_\_\_\_\_ INCOME TAX. File No. \_\_\_\_\_  
 \_\_\_\_\_ District of \_\_\_\_\_ FOR FAILURE TO HAVE THIS RETURN IN Assessment List \_\_\_\_\_  
 Date received \_\_\_\_\_ THE HANDS OF THE COLLECTOR OF Page \_\_\_\_\_ Line \_\_\_\_\_  
INTERNAL REVENUE ON OR BEFORE  
MARCH 1 IS \$20 TO \$1,000.  
(SEE INSTRUCTIONS ON PAGE 4)

**UNITED STATES INTERNAL REVENUE.**

**RETURN OF ANNUAL NET INCOME OF INDIVIDUALS.**  
(As provided by Act of Congress, approved October 3, 1913.)

**RETURN OF NET INCOME RECEIVED OR ACCRUED DURING THE YEAR ENDED DECEMBER 31, 191 ...**  
(FOR THE YEAR 1913, FROM MARCH 1, TO DECEMBER 31.)

Filed by (or for) \_\_\_\_\_ of \_\_\_\_\_  
(Full name of individual.) (Street and No.)

in the City, Town, or Post Office of \_\_\_\_\_ State of \_\_\_\_\_  
(Fill in pages 2 and 3 before making entries below.)

1. GROSS INCOME (see page 2, line 12) . . . . .	\$				
2. GENERAL DEDUCTIONS (see page 3, line 7) . . . . .	\$				
<b>3. NET INCOME</b> . . . . .	<b>\$</b>				
Deductions and exemptions allowed in computing income subject to the normal tax of 1 per cent.					
4. Dividends and net earnings received or accrued, of corporations, etc., subject to like tax. (See page 2, line 11) . . . . .	\$				
5. Amount of income on which the normal tax has been deducted and withheld at the source. (See page 2, line 9, column A) . . . . .					
6. Specific exemption of \$3,000 or \$4,000, as the case may be. (See Instructions 3 and 19) . . . . .					
Total deductions and exemptions. (Items 4, 5, and 6) . . . . .	\$				
<b>7. TAXABLE INCOME</b> on which the normal tax of 1 per cent is to be calculated. (See Instruction 3) . . . . .	<b>\$</b>				

8. When the net income shown above on line 3 exceeds \$20,000, the additional tax thereon must be calculated as per schedule below:

	INCOME.	TAX.
1 per cent on amount over \$20,000 and not exceeding \$50,000 . . . . .	\$	\$
2 " " 50,000 " " 75,000 . . . . .		
3 " " 75,000 " " 100,000 . . . . .		
4 " " 100,000 " " 250,000 . . . . .		
5 " " 250,000 " " 500,000 . . . . .		
6 " " 500,000 . . . . .		
Total additional or super tax . . . . .	\$	\$
Total normal tax (1 per cent of amount entered on line 7) . . . . .	\$	\$
Total tax liability . . . . .	\$	\$



**SPOTLIGHT ON TAXATION**

**Who Pays the Income Tax?**

The 1913 income tax was strictly a tax on wealthy and high income taxpayers (i.e., a “select tax”). The original post-Sixteenth Amendment income tax applied to less than 1 percent of the population (i.e., 1 in every 271 adults). It wasn’t until the end of World War II that the income tax became a broad-based tax that applied to the majority of the population (i.e., a “mass tax”).

In recent years, the income tax has been attacked in the courts on the basis that it is unconstitutional. For instance, some protesters have asserted that, since the U.S. currency no longer is based on the gold standard, the Sixteenth Amendment's measure of income, and therefore the tax itself, is invalid. Others have asserted that the Federal income tax law forces the taxpayer to surrender his or her Fifth Amendment rights against self-incrimination. Federal courts, however, have denied virtually all of the protesters' challenges.

Congress has passed several laws to discourage tax protesters. For instance, a taxpayer is subject to a \$5,000 fine if he or she files a "frivolous" tax return as a form of protest against the IRS or the U.S. budgetary process. This fine would be levied, for example, when the taxpayer files a blank tax return accompanied by a note suggesting that the Federal income tax is unconstitutional or that the taxpayer wishes to protest against tax revenues going to the creation of nuclear weapons. A number of lower courts have upheld the constitutionality of this fine [e.g., *Schull*, 842 USTC ¶ 9529 (D.C., Va.)].

The Tax Court can impose a penalty, not to exceed \$25,000, if the taxpayer brings a "frivolous" matter before the Court. Under §§6673 and 6702, a frivolous matter is where the intent is to delay the revenue collection process and where the proceedings are found to be groundless, or where the taxpayer unreasonably failed to pursue available administrative remedies. Sanctions can also be imposed against tax practitioners who participate in the litigation of frivolous tax return positions.

## U.S. CONSTITUTION

The Constitution of the United States is the source of all of the Federal laws of the country, including both tax and nontax provisions. In addition to the Sixteenth Amendment, however, the Constitution contains other provisions that bear upon the taxation process. For example, the Constitution provides that Congress may impose import taxes but not export taxes. Moreover, the constitutional rights of due process and of the privacy of the citizen apply in tax, as well as nontax, environments.

The Constitution also requires that taxes imposed by Congress apply uniformly throughout the United States. For instance, it would be unconstitutional for Congress to impose one Federal income tax rate in California and another rate in Vermont. Moreover, except as provided by the Sixteenth Amendment, the Constitution still bars per capita and other direct taxes, unless the revenues that are generated from these taxes are apportioned to the population of the states from which they were collected.

The Federal courts have upheld the constitutionality of the estate and gift taxes because they are in the form of excise taxes on (the transfer of) property, rather than direct taxes on individuals. Thus, one can conclude that, for better or worse, most future judicial challenges to the constitutionality of the elements of the Federal tax structure probably will be fruitless.

One can find copies of the U.S. Constitution in many textbooks, encyclopedias, dictionaries, and in publications such as *The World Almanac* and *Wikipedia*. The Constitution is also reproduced in Volume One of the *United States Code*, as published by the Government Printing Office.

An excerpt from the U.S. Constitution can be found in Exhibit 3-3. The Constitution can also be found at various Internet sites. An example of such a site is:

<http://www.archives.gov>

**Exhibit 3-3: United States Constitution Excerpt (with original spelling)**

WE THE PEOPLE of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.

**Article I**

Section. 1. All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

Section. 2. The House of Representatives shall be composed of Members chosen every second Year by the People of the several States, and the Electors in each State shall have the Qualifications requisite for Electors of the most numerous Branch of the State Legislature.

No Person shall be a Representative who shall not have attained to the Age of twenty five Years, and been seven Years a Citizen of the United States, and who shall not, when elected, be an Inhabitant of that State in which he shall be chosen.

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons. The actual Enumeration shall be made within three Years after the first Meeting of the Congress of the United States, and within every subsequent Term of ten Years, in such Manner as they shall by Law direct. The Number of Representatives shall not exceed one for every thirty Thousand, but each State shall have at Least one Representative; and until such enumeration shall be made, the State of New Hampshire shall be entitled to chuse three, Massachusetts eight, Rhode-Island and Providence Plantations one, Connecticut five, New-York six, New Jersey four, Pennsylvania eight, Delaware one, Maryland six, Virginia ten, North Carolina five, South Carolina five, and Georgia three.

When vacancies happen in the Representation from any State, the Executive Authority thereof shall issue Writs of Election to fill such Vacancies.

The House of Representatives shall chuse their Speaker and other Officers; and shall have the sole Power of Impeachment.

Section. 3. The Senate of the United States shall be composed of two Senators from each State, chosen by the Legislature thereof, for six Years; and each Senator shall have one Vote.

Immediately after they shall be assembled in Consequence of the first Election, they shall be divided as equally as may be into three Classes. The Seats of the Senators of the first Class shall be vacated at the Expiration of the second Year, of the second Class at the Expiration of the fourth Year, and of the third Class at the Expiration of the sixth Year, so that one third may be chosen every second Year; and if Vacancies happen by Resignation, or otherwise, during the Recess of the Legislature of any State, the Executive thereof may make temporary Appointments until the next Meeting of the Legislature, which shall then fill such Vacancies.

No Person shall be a Senator who shall not have attained to the Age of thirty Years, and been nine Years a Citizen of the United States, and who shall not, when elected, be an Inhabitant of that State for which he shall be chosen.

The Vice President of the United States shall be President of the Senate, but shall have no Vote, unless they be equally divided.

## TAX TREATIES

**Tax treaties** are agreements negotiated between countries concerning the treatment of entities subject to tax in both countries. The United States has entered into treaties with most of the major Western countries of the world. The overriding purpose of such treaties (also known as *tax conventions*) is to eliminate the “double taxation” that the taxpayer would face if his or her income were subject to tax in both countries. In such a case, a U.S. citizen who has generated income from an investment in the United Kingdom (U.K.) usually would be allowed a credit on her U.S. income tax return to the extent of any related U.K. taxes that she paid.

Any tax matter can be covered in a tax treaty with another country. Many times, there are multiple tax treaties with a given country. For example, one treaty will address income tax issues, while another treaty covers estate tax, and a third treaty addresses excise taxes. An example of a portion of a tax treaty is shown as Exhibit 3-4.

In addition to the tax treaties, the U.S. government enters into nontax international agreements that are not formal tax treaties; however, in many respects they function like one. Along with other provisions, these agreements address tax issues involving the parties associated with the agreement. Examples of such international agreements include the North American Free Trade Agreement (NAFTA) and the General Agreement on Tariffs and Trade (GATT). Other agreements might address the exchange of tax, banking, and securities information among citizens of one or more countries.

Treaties are an important source of Federal law. Most treaties do *not* address tax issues, but the ones that do have a far-reaching effect. When dealing with a research problem that has international connotations, the researcher must locate, read, and evaluate any tax treaty that applies to the client’s problem. The researcher cannot rely on the more typical sources of tax research information because these

**Exhibit 3-4: Tax Treaty Excerpt**

The screenshot shows a web browser window with the address bar displaying "http://checkpoint.riag.com/Checkpoint/ussd-2e16282b2c88e...". The page content includes:

**RIA Checkpoint**

Full Text - Ukraine: Income tax 1994  
U.S. Tax Treaties in Force

**Income Tax Treaty with Ukraine. The treaty entered into force on June 5, 2000.**

**CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF UKRAINE FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL**

The Government of the United States of America and the Government of Ukraine, confirming their desire to develop and strengthen the economic, scientific, technical and cultural cooperation between both States, and desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital, have agreed as follows:

**ARTICLE 1 General Scope**

1. This Convention shall apply to persons who are residents of one or both of the Contracting States and to other persons as specifically provided in the Convention.
2. The Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded:
  - a) by the laws of either Contracting State; or
  - b) by any other agreement between the Contracting States.
3. Notwithstanding any provision of the Convention except paragraph 4, a Contracting State may tax, in accordance with its domestic law, residents (as determined under [Article 4](#) (Residence)) of that State, and in the case of the United States, its citizens and former citizens.
4. The following benefits shall be conferred by a Contracting State notwithstanding the provisions of paragraph 3:
  - a) under [paragraph 7 of Article 9](#) (Associated Enterprises), [paragraph 1 of Article 19](#) (Pensions) and [Articles 24](#) (Relief from Double Taxation), [25](#) (Non-discrimination) and [26](#) (Mutual Agreement Procedure), and
  - b) under [Articles 18](#) (Government Service), [20](#) (Students, Trainees and Researchers), and [23](#) (Diplomatic Agents and Consular Officers) for individuals who are neither citizens of that State nor, in the case of the United States of America, individuals having immigrant status therein.

**ARTICLE 2 Taxes Covered**

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references usually address only domestic tax precedents. Tax treaties often address issues such as the following.

- How to treat the business and investment income of the visiting taxpayer
- When the visitor is subject to the host country's tax laws
- How to offset the possibility of taxing the same income or assets more than once
- How to compute the taxable amount in the host country
- To what extent host-country withholding taxes are applied to the visitor's transactions
- How taxes levied by a state/province/canton are treated by the taxpayer
- What tax disclosures must be made by the visitor

The Constitution provides that "Laws of the United States which shall be made in pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land." An *Internal Revenue Code* provision and a provision under a treaty will sometimes conflict. In such a case, both of the provisions cannot represent the law; the one adopted later in time generally controls.

**Example 3-1 Treaty Override.** Prior to 1980, the United States negotiated treaties with several countries that allowed foreign taxpayers to sell U.S. real estate and not pay tax on gains. Under these treaties, nonresident aliens and foreign corporations could avoid U.S. taxes on real estate if the gains were treated as capital gains and were not effectively connected with the conduct of a U.S. business. Because of this favorable treatment for foreign investors, many U.S. farmers felt foreign investors were bidding up the price of farmland in the United States. This and other concerns led Congress to pass the Foreign Investment in Real Property Tax Act (FIRPTA) of 1980. Under §897, FIRPTA makes gains and losses by nonresident aliens and foreign corporations taxable by treating such transactions as effectively connected with a U.S. trade or business. This provision overrides any treaties in effect at that time by making foreign capital gains on real property taxable for transactions after 1984. If an existing treaty was renegotiated prior to 1985, the new treaty could designate a different effective date for §897; however, the designated effective date could not be more than two years after the signing of the renegotiated treaty.

This later-in-time rule appears to be a simplistic approach to the complex interaction of the Code and treaty provisions. The courts have presented interpretive guidelines to be used in resolving interstatutory conflicts. One such guideline is that, where possible, equal effect should be given to both statutes; congressional intent to repeal a statute should not be assumed. A significant judicial history also exists for the interaction of treaties and the Code. In fact, as with conflicts between statutes, courts usually attempt to reconcile the apparent conflict in a way that gives consideration to both the treaty and the Code provisions.

The equality of the two types of provisions is indicated in §7852(d) of the Code, which provides that neither a treaty nor a law shall be given preferential status by reason of its being a treaty or a law. The language of both the Code and the Constitution make this clear. The only codified exception to this rule is that treaty provisions in effect in 1954 and which conflicted with the 1954 Code as originally



enacted are given precedence over the existing provisions of the 1954 Code, but not over later amendments to the Code. Section 894 states that due regard shall be given to any treaty obligation of the United States that applies to the taxpayer when applying the provisions of the *Internal Revenue Code*.

Treaties are authorized by the U.S. Constitution. Under Article II, Section 2, of the Constitution, the President of the United States is allowed to enter into treaties with other countries after receiving the advice and consent of the Senate. The President may also enter into other international agreements that have effects on the Federal tax structure. Such agreements need not be ratified by the Senate; however, they are implemented by Congress in accordance with existing Federal laws. But tax treaties usually are initiated by the State Department, not the Treasury. Generally, tax treaties do not address the U.S. state and local tax effects of the citizens and transactions covered by them.

Treaties may be terminated in several ways. They may expire because of a specific congressional time limitation, be superseded by a newer treaty, or be terminated by the countries' mutual actions.

Tax researchers often find it necessary to examine the provisions of tax treaties. Tax treaties can be found in both the online and printed versions of most tax services, at the government web sites of many countries, and in many legal publications such as West's *United States Code Annotated*.

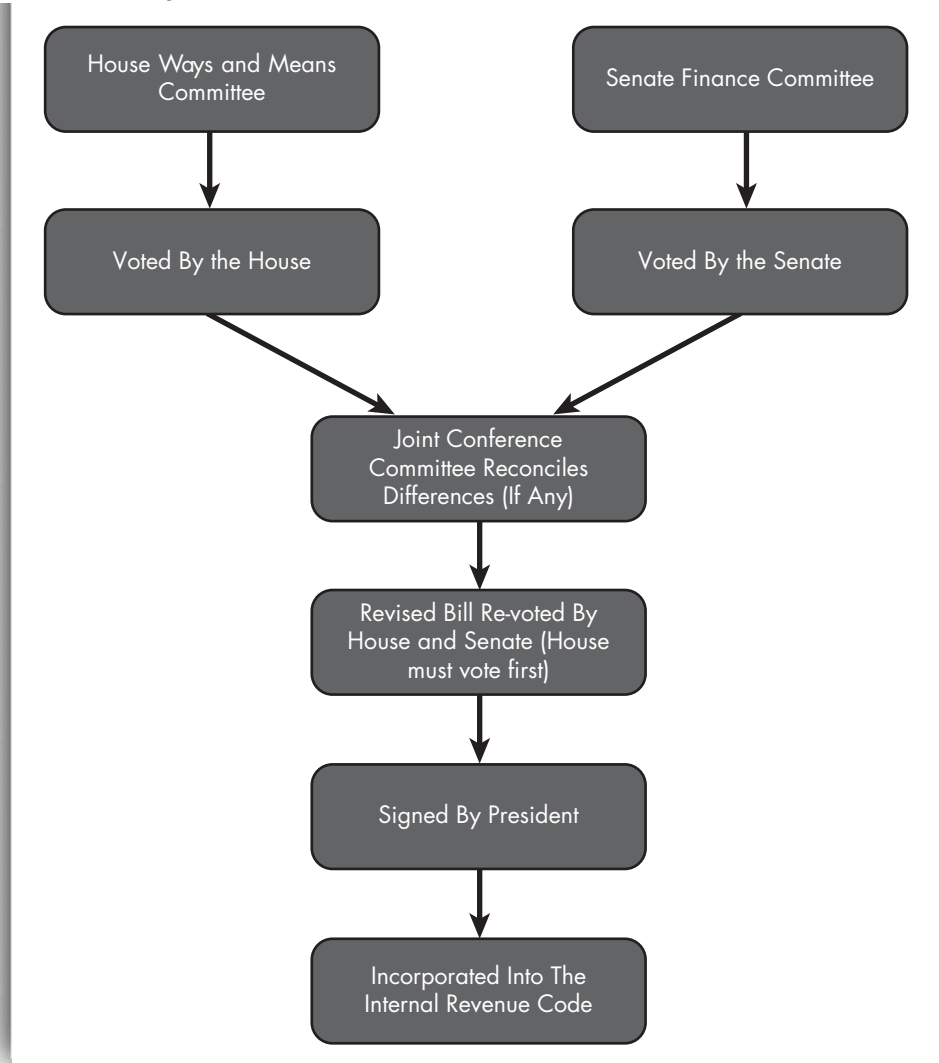
## THE LEGISLATIVE PROCESS

To understand how to research tax issues, the tax researcher must have a grasp of the Federal legislative process. The tax law of the United States, like automobiles and hot dogs, is created in a multistep process. At each stage in the creation of a tax law, Congress generates additional items of information, each of which may be useful in addressing a client's tax problem.

Most tax legislation begins in the House of Representatives. In the House, tax law changes are considered by the Ways and Means Committee. Upon approval by this committee, the bill is sent to the full House of Representatives for its approval. The bill then is sent to the Senate, where it is referred to the Finance Committee. When the Finance Committee approves the bill, the proposal is considered by the entire Senate.

If any differences between the House and Senate versions of the tax bill exist (which is almost always the case), the bill is referred to a Joint Conference Committee, where these differences are resolved. The compromise bill must be approved by both houses of Congress before it is forwarded to the President. If the President signs the bill, the new provisions are incorporated into the *Internal Revenue Code*. If the bill is vetoed by the President, however, it is not enacted, unless Congress overrides the veto with a sufficient revote. Exhibit 3-5 summarizes the usual steps of the legislative process as it is encountered relative to tax legislation.

At each step in the legislative process, the appropriate committee of Congress produces a **Committee Report**, which explains the elements of the proposed changes and the reasons for each of the proposals. These Committee Reports are an important tool for tax researchers. In many situations where the tax law is unclear, or when recent legislation has been passed, they can provide insight concerning the meaning of a specific phrase of the statute or of the intention of Congress concerning a certain provision of the law. Committee Reports typically result from the deliberations of the Ways and Means Committee, the Finance Committee, and the Joint Conference Committee. A "General Explanation" of tax legislation occasionally is prepared by the Joint Committee on Taxation (the "Blue Book"). Exhibit 3-6 reproduces a portion of such a Committee Report.

**Exhibit 3-5: Legislative Process to Amend the Tax Law**

Committee Reports generally are referred to by Public Law number. Every bill that Congress passes is assigned such a number. For example, the Tax Reform Act of 1986 was designated as P.L. 99-514. Public Law is abbreviated as “P.L.” in this context. The prefix of the numerical designation (here, 99) refers to the session of Congress that passed the law. The suffix of the Public Law number (here, 514) indicates that this was the five-hundred-fourteenth bill that this session of Congress adopted.

Congressional sessions last for two years; therefore, the researcher may find it useful to construct a method by which to identify the two-year period in which a tax law was passed. The recent sessions of Congress are identified as follows.

<b>Congressional Sessions</b>	<b>Years</b>
One-hundred-seventh	2001–02
One-hundred-eighth	2003–04
One-hundred-ninth	2005–06
One-hundred-tenth	2007–08
One-hundred-eleventh	2009–10
One-hundred-twelfth	2011–12

**Exhibit 3-6: Committee Report**

Conference Report 107-84: ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001, PL 107-16

**PRESENT LAW**

Under the Code, gross income means, "Income from whatever source derived" except for certain items specifically exempt or excluded by statute (sec. 61). There is no explicit statutory exception from gross income provided for amounts received by Holocaust victims or their heirs.

**HOUSE BILL**

No provision.

**SENATE AMENDMENT**

The Senate amendment provides that excludible restitution payments made to an eligible individual (or the individual's heirs or estate) are: (1) excluded from gross income; and (2) not taken into account for any provision of the Code which takes into account excludable gross income in computing adjusted gross income (e.g., taxation of Social Security benefits).

The basis of any property received by an eligible individual (or the individual's heirs or estate) that is excluded under this provision is the fair market value of such property at the time of receipt by the eligible individual (or the individual's heirs or estate).

The Senate amendment provides that any excludible restitution payment is disregarded in determining eligibility for, and the amount of benefits and services to be provided under, any Federal or federally assisted program which provides benefit or service based, in whole or in part, on need. Under the Senate amendment, no officer, agency, or instrumentality of any government may attempt to recover the value of excessive benefits or services provided under such a program before January 1, 2000, by reason of failure to take account of excludible restitution payments received before that date. Similarly, the Senate amendment requires a good faith effort to notify any eligible individual who may have been denied such benefits or services of their potential eligibility for such benefits or services. The Senate amendment also provides coordination between this bill and Public Law 103-286, which also disregarded certain restitution payments in determining eligibility for, and the amount of certain needs-based benefits and services.

Eligible restitution payments are any payment or distribution made to an eligible individual (or the individual's heirs or estate) which: (1) is payable by reason of the individual's status as an eligible individual (including any amount payable by any foreign country, the United States, or any foreign or domestic entity or fund established by any such country or entity, any amount payable as a result of a final resolution of legal action, and any amount payable under a law providing for payments or restitution of property); (2) constitutes the direct or indirect return of, or compensation or reparation for, assets stolen or hidden, or otherwise lost to, the individual before, during, or immediately after World War II by reason of the individual's status as an eligible individual (including any proceeds of insurance under policies issued on eligible individuals by European insurance companies immediately before and during World War II); or (3) interest payable as part of any payment or distribution described in (1) or (2), above. An eligible individual is a person who was persecuted for racial or religious reasons by Nazi Germany, or any other Axis regime, or any other Nazi-controlled or Nazi-allied country.

**EFFECTIVE DATE**

The provision is effective for any amounts received on or after January 1, 2000. No inference is intended with respect to the income tax treatment of any amount received before January 1, 2000.

*continued*

**Exhibit 3-6: (continued)****CONFERENCE AGREEMENT**

The conference agreement follows the Senate amendment, with three changes. First, the definition of eligible individuals is expanded to also include individuals persecuted on the basis of physical or mental disability or sexual orientation. Second, interest earned by enumerated escrow or settlement funds are also excluded from tax. Third, the provision disregarding excludible restitution in determining eligibility for and the benefit calculation of certain Federal or Federally assisted programs is deleted.

To convert a session number into the second year of the applicable congressional session, multiply the session number by 2 and subtract 212 (the number of years from 1788 to 2000). For example, the second year of the one-hundred-ninth Congress is 2006  $[(109 \times 2) - 212 = 06]$ .

**Where to Find Committee Reports**

When a new tax law is passed, the pertinent Committee Reports are released in the Internal Revenue Service's weekly *Internal Revenue Bulletin*. The texts of the 1954 Committee Reports relative to the *Internal Revenue Code* are found not in the *Cumulative Bulletin*, but in the *United States Code Congressional and Administrative News*. All of the pre-1939 Revenue Act Committee Reports are reprinted in the 1939 *Cumulative Bulletin*.

The Committee Reports and other legislative items can also be found in most subscription online tax services (e.g., RIA Checkpoint) and on various nonsubscription Internet sites such as:

<http://thomas.loc.gov>

<http://waysandmeans.house.gov/>

<http://www.senate.gov/~finance/>

Commerce Clearing House and the Research Institute of America both publish, usually in paperback form, a collection of Committee Reports (or excerpts thereof) whenever a major new tax law is passed. If a tax researcher wants to find the Committee Reports that underlie a statutory provision, he or she also can use reference materials that are included in the bodies of most of the commercial tax services or in the index to the *Cumulative Bulletin*.

The Committee Reports Findings List in Commerce Clearing House's *Citator*, Volume M–Z, is a good place for the tax researcher to locate Committee Reports by P.L. number. See Part 3 of this text for a detailed review of the use of citators.

In addition to the Committee Reports, the Floor Debate Report may be of value to the tax researcher. The Floor Debate Report includes a summary of what was said from the floor of the House or Senate concerning the proposed bill. It may include some detailed or technical information that is excluded from the Committee Report. The Floor Debate Report is included in the *Congressional Record* for the day of the debate.

**INTERNAL REVENUE CODE**

After the Sixteenth Amendment was ratified in 1913, Congress passed a series of self-contained revenue acts, each of which formed the entire income tax law of the United States. For about two decades, Congress passed such a free-standing revenue act every year or two. By the 1930s, however, this series of revenue acts,

and the task of rewriting the entire tax statute so often, had become unmanageable. Thus, in 1939, Congress replaced the revenue acts with the *Internal Revenue Code of 1939*, the first fully organized Federal tax law.

Although the concept of a free-standing tax Code, as part of the entire *United States Code*, was a good idea, the organization of the *Internal Revenue Code of 1939* left little room to accommodate subsequent changes to the law. Accordingly, the 1939 Code was replaced with a reorganized, more flexible codification in 1954. Due to extensive revisions to the Code that were made as part of the Tax Reform Act of 1986, the statute was renamed the *Internal Revenue Code of 1986*. Thus, although the statute still follows the 1954 numbering system and organization, the official title of the extant U.S. tax law is the *Internal Revenue Code of 1986, as Amended*.

The principal sources of tax laws of the United States since 1913, then, have been identified as follows.

Period	Principal U.S. Tax Law
1913–39	<i>Periodic Revenue Acts</i>
1939–54	<i>Internal Revenue Code of 1939</i>
1954–86	<i>Internal Revenue Code of 1954</i>
1986–Present	<i>Internal Revenue Code of 1986</i>

Many provisions of the 1939 Code were carried over to the *Internal Revenue Code of 1954* without substantive change; some of these sections were adopted into the Code verbatim, although all of the sections were renumbered as part of the 1954 reorganization.



## SPOTLIGHT ON TAXATION

### Growth of the Code

If you think the tax law is getting more complex, you're correct. According to the Tax Foundation, in 1955 the *Internal Revenue Code* contained 106 Code sections and 409,000 words. Today there are about 1,000 Code sections containing more than 2,139,000 words.

The *Internal Revenue Code* is part of the *United States Code*, which is a codification of all of the Federal laws of the United States. The elements of the *United States Code* are organized alphabetically and assigned title numbers. Accordingly, the *Internal Revenue Code* constitutes Title 26 of the *United States Code*; its neighbors in the *U.S. Code* at one time included “Insane Asylums” and “Intoxicating Liquors.”

### Organization of the Internal Revenue Code

The *Internal Revenue Code* is organized into an outline form with multiple levels or subdivisions. The primary levels found in the Code are as follows.

#### Subtitles

#### Chapters

#### Subchapters

#### Parts

#### Sections

#### Subsections

Subtitles of the Code are assigned a capital letter to identify them (currently A through K are used). Generally, each subtitle contains all of the tax provisions that relate to a well-defined area of the tax law. Exhibit 3-7 identifies the subtitles of the current Code. The tax researcher spends most of his or her time working with Subtitles A, Income Taxes; B, Estate and Gift Taxes; and F, Procedure and Administration. The other subtitles typically are used only from time to time for special research problems.

Each subtitle contains a number of chapters, numbered, although not continuously, from 1 through 100. These chapter numbers do not start over at each subtitle; rather, they are used in ascending order throughout the Code. Thus, for example, there is only one Chapter 11 in the *Internal Revenue Code*, not eleven of them. Each chapter contains the tax provisions that relate to a more narrowly defined area of the tax law than is addressed by the subtitles. Most of the subtitles include several chapters. Exhibit 3-8 examines the numbering system of the chapters of the *Internal Revenue Code*, concentrating on selected important chapters.

The chapters of the *Internal Revenue Code* are further divided into subchapters. Typically a subchapter contains a group of provisions that relates to a fairly specific area of the tax law. Subchapters sometimes are divided into parts, which may be divided into subparts. Letters are used to denote subchapters, and the lettering scheme starts over with each chapter. Thus, there may be a Subchapter A in each chapter.

Many times, tax practitioners use the subchapter designation as a shorthand reference to identify a certain area of taxation. For example, Subchapter C of

**Exhibit 3-7: Subtitles of the *Internal Revenue Code*, as Amended**

Subtitle	Tax Law Included
A	Income Taxes
B	Estate and Gift Taxes
C	Employment Taxes
D	Miscellaneous Excise Taxes
E	Alcohol; Tobacco; Miscellaneous Excise Taxes
F	Procedure and Administration
G	Joint Committee on Taxation
H	Presidential Election Campaign Financing
I	Trust Funds

**Exhibit 3-8: Key Chapters of the *Internal Revenue Code***

Chapter	Subjects Included
1	Normal Taxes and Surtaxes
2	Self-Employment Tax
6	Consolidated Returns
11	Estate Taxes
12	Gift Taxes
61	Administration/Information
79	Definitions

Chapter 1 of Subtitle A of the *Internal Revenue Code* includes many of the basic corporate income tax provisions. Thus, when a tax practitioner wants to refer to a corporate tax matter, he or she often simply identifies it as a “Subchapter C” issue.

Most of the Code’s subchapters are divided into parts. The parts provide a natural grouping of provisions that address essentially the same issue. Not all subchapters are divided into parts, and occasionally the parts are not numbered consecutively. For instance, the parts of Chapter 1, Subchapter A (i.e., normal income taxes), are:

Part I	Tax on Individuals
Part II	Tax on Corporations
Part III	Changes in Rates during a Taxable Year
Part IV	Credits against Tax
Part V	Not Used
Part VI	Alternative Minimum Tax
Part VII	Environmental Tax

Exhibit 3-9 shows the Table of Contents to Subtitle A (Income Taxes) of the Code with the “Parts” level shown for Subchapters A, B, and C. To save space, the “Parts” level is not shown for the other subchapters.

**Exhibit 3-9: Subtitle A: Table of Contents Excerpt**

Subtitle A Income Taxes	§§1-1564
Chapter 1 Normal Taxes and Surtaxes	§§1-1400t
Subchapter A Determination of Tax Liability	§§1-59b
Part I Tax on Individuals	§§1-5
Part II Tax on Corporations	§§11-12
Part III Changes in Rates During a Taxable Year	§§15-15
Part IV Credits Against Tax	§§21-54
Part VI Alternative Minimum Tax	§§55-59
Part VII Environmental Tax	§§59a-59a
Part VIII Supplemental Medicare Premium [Repealed]	§§59b-59b
Subchapter B Computation of Taxable Income	§§61-291
Part I Definition of Gross Income, Adjusted Gross Income, Taxable Income, Etc.	§§61-68
Part II Items Specifically Included in Gross Income	§§71-90
Part III Items Specifically Excluded from Gross Income	§§101-140
Part IV Tax Exemption Requirements for State and Local Bonds	§§141-150
Part V Deductions for Personal Exemptions	§§151-153
Part VI Itemized Deductions for Individuals and Corporations	§§161-199
Part VII Additional Itemized Deductions for Individuals	§§211-224
Part VIII Special Deductions for Corporations	§§241-249
Part IX Items Not Deductible	§§261-280h
Part X Terminal Railroad Corporations and Their Shareholders	§§281-281
Part XI Special Rules Relating to Corporate Preference Items	§§291-291
Subchapter C Corporate Distributions and Adjustments	§§301-385
Part I Distributions by Corporations	§§301-318
Part II Corporate Liquidations	§§331-346
Part III Corporate Organizations and Reorganizations	§§351-368

*continued*

**Exhibit 3-9: (continued)**

Part IV Insolvency Reorganizations [Repealed] §§370-374  
 Part V Carryovers §§381-384  
 Part VI Treatment of Certain Corporate Interests as Stock or Indebtedness §§385-385  
 Part VII Miscellaneous Corporate Provisions [Repealed] §§386-386  
 Subchapter D Deferred Compensation, Etc. §§401-436  
 Subchapter E Accounting Periods and Methods of Accounting §§441-483  
 Subchapter F Exempt Organizations §§501-530  
 Subchapter G Corporations used to Avoid Income Tax on Shareholders §§531-565  
 Subchapter H Banking Institutions §§581-597  
 Subchapter I Natural Resources §§611-638  
 Subchapter J Estates, Trusts, Beneficiaries, and Decedents §§641-692  
 Subchapter K Partners and Partnerships §§701-777  
 Subchapter L Insurance Companies §§801-848  
 Subchapter M Regulated Investment Companies and Real Estate Investment  
     Trusts §§851-860L  
 Subchapter N Tax Based on Income from Sources within or without The United States  
     §§861-999  
 Subchapter O Gain or Loss on Disposition of Property §§1001-1111  
 Subchapter P Capital Gains and Losses §§1201-1298  
 Subchapter Q Readjustment of Tax between Years and Special Limitations §§1301-1351  
 Subchapter R Election to Determine Corporate Tax on Certain International Shipping ...  
     §§1352-1359  
 Subchapter S Tax Treatment of S Corporations and Their Shareholders §§1361-1379  
 Subchapter T Cooperatives and Their Patrons §§1381-1388  
 Subchapter U Designation and Treatment of Empowerment Zones, Enterprise ...  
     §§1391-1397e  
 Subchapter V Title 11 Cases §§1398-1399  
 Subchapter W District of Columbia Enterprise Zone §§1400-1400c  
 Subchapter X Renewal Communities §§1400e-1400j  
 Subchapter Y Short-Term Regional Benefits §§1400l-1400t  
 Chapter 2 Tax On Self-Employment Income §§1401-1403  
 Chapter 3 Withholding of Tax on Nonresident Aliens and Foreign Corporations  
     §§1441-1464

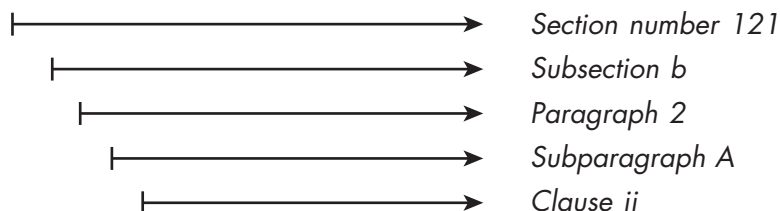
The most important division of the *Internal Revenue Code* for the tax researcher is the section, because the Code is arranged so that its primary unit is the section number. The sections currently are numbered 1 through 9833, although not all of the numbers are used. Each section number is used only once in the Code. The researcher can refer to a specific provision of the *Internal Revenue Code* by its section number and not be concerned about duplication in another part of the law. Indeed, the most common element of the jargon of the tax practitioner community is the Code section number, and tax researchers must learn to identify important tax provisions merely by the corresponding section number.

Code sections can be divided into various smaller elements for the convenience of the drafter or user of the section. A section can contain subsections, paragraphs, subparagraphs, and clauses. Sections are denoted by numbers (1, 2, etc.), subsections by lowercase letters (a, b, etc.), paragraphs by numbers, sub-



**Exhibit 3-10: Interpreting a Code Section Citation**

Section 121(b)(2)(A)(ii)



Section 121	SEC. 121. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE
Subsection(a)	<p>(a) Exclusion</p> <p>Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.</p>
Subsection(b)	(b) Limitations
Paragraph(1)	<p>(1) In general</p> <p>The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed \$250,000.</p>
Paragraph(2)	<p>(2) Special rules for joint returns</p> <p>In the case of a husband and wife who make a joint return for the taxable year of the sale or exchange of the property—</p>
Subparagraph(A)	<p>(A) \$500,000 Limitation for certain joint returns</p> <p>Paragraph (1) shall be applied by substituting "\$500,000" for "\$250,000" if—</p>
Clause(i)	(i) either spouse meets the ownership requirements of subsection (a) with respect to such property;
Clause(ii)	(ii) both spouses meet the use requirements of subsection (a) with respect to such property; and
Clause(iii)	(iii) neither spouse is ineligible for the benefits of subsection (a) with respect to such property by reason of paragraph (3)

paragraphs by capital letters (A, B, etc.), and clauses by lowercase roman numerals (i, ii, etc.). In citing a Code section, one uses parentheses for each division that occurs after the section number.

There are some exceptions to the general formatting of Code section citations. For example, Congress has inserted Code sections in between other consecutive

**Exhibit 3-11: Some Important Code Sections**

Section Number	Contents
1	Individual Tax Rates
11	Corporate Tax Rates
61	Definition of Gross Income
62	Deductions for Adjusted Gross Income
162	Trade or Business Deductions
163	Interest Deduction
164	Deduction for Taxes
165	Losses
167, 168, 179	Depreciation, Cost Recovery
212	Production-of-Income Expenses
312	Corporate Dividends
351	Forming a Corporation
368	Mergers, Acquisitions, Corporate Break-Ups
469	Passive Activities
501	Tax-Exempt Status
721	Forming a Partnership, LLC
861	Sourcing of International Income and Deductions
904	Foreign Tax Credit
1245	Depreciation Recapture
1504	Consolidated Taxable Income
6662	Penalties for Inaccurate Tax Filings

sections and has had to use a capital letter [e.g., Section 25A(b)(1) or Section 280F(a)(1)] to accomplish this. The Code skips the subsections in certain cases, such as Section 212(2). Exhibit 3-10 provides a specific interpretation of a Code section citation.

Although there are nearly a thousand Code sections, certain ones contain basic principles that affect most tax situations (Exhibit 3-11). The tax researcher should be familiar with this group of Code sections for efficient analysis of his or her clients' tax problems.

**Where to Find the Internal Revenue Code**

The amended *Internal Revenue Code* can be found in several places. National publishers such as Research Institute of America (RIA), West, and Commerce Clearing House (CCH) publish paperback versions of the Code for use by tax practitioners. In addition, the text of the Code may be found in most commercial tax services and as Title 26 of the *United States Code*.

The type of tax service will indicate the probable location of the original language of the Code in the service. Typically, an annotated tax service (refer to Chapter 2 to review this definition) will include the text of the Code with the related section's discussion. On the other hand, a topical tax service typically reproduces the text of the Code in an appendix to pertinent chapters or volumes of the service.

The *U.S. Code* and the *Internal Revenue Code* (which is Title 26 of the *U.S. Code*) can also be found at various Internet sites. An example of such a site would be:

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

**Exhibit 3-12: Examples of 1986 Code Sections Derived from the 1939 Code**

1986 Code Section	1939 Code Section
§61, Gross income defined	§22(a)
§71, Alimony and separate maintenance payments	§22(k)
§103, Interest on state and local bonds	§22(b)(4)
§151, Allowance of deductions for personal exemptions	§25(b)
§162, Trade or business expenses	§23(a)(1)
§172, Net operating loss deduction	§122
§212, Expenses for production of income	§23(a)(2)
§301, Distributions of property	§22(e), 115(a), (b), (d), (e)
§316, Dividends defined	§115(a) and (b)
§701, Partners, not partnership, subject to tax	§181

Occasionally, a tax researcher needs to refer to a source that originated from the *Internal Revenue Code of 1939*. Many of the provisions of the 1986 (and 1954) Code can be found in the 1939 Code. Exhibit 3-12 gives examples of 1986 Code sections and their 1939 Code equivalents.

Other useful indices to the Code itself are provided by the editors of the tax services. For example, several useful tables are included in the Code volumes of the Commerce Clearing House tax service. In Cross-Reference Table 1, 1939 Code sections are cross-referenced to their 1954 (and 1986) counterparts. In Table 2 of the CCH service, current Code sections are cross-referenced to the 1939 Code.

Table III of this feature cross-references the Code sections within the current Code. These three tables can be useful to the tax researcher when he or she needs to find a 1939 Code section number, perhaps in interpreting a court case that addresses a pre-1954 Code issue, or in identifying situations where a Code section is referred to elsewhere in the current Code, or perhaps to find out whether other Code sections provide information bearing on the section being reviewed.

Most tax services also contain information about the history of each Code section. Typically, at the end of the text of each Code section, or as a related page that can be accessed by linking, the editors include a list of the Public Laws that have altered or amended the section. This listing generally includes a reference to the section as it existed prior to amendment, as well as the effective date of the amendment to the law. The tax researcher must be careful to consider the impact of any such amendments. Exhibit 3-13 illustrates the Public Law history with respect to a specific Code section.

**Exhibit 3-13: Recent Amendments to Section 121**

In 2003, P.L. 108-121, Sec. 101(a), redesignated para. (d)(9) as (10) and added para. (d)(9), effective for sales and exchanges after 5/6/97. For special rules, see Sec. 312(d)(2)-(4) of P.L. 105-34, reproduced below.

—P.L. 108-121, Sec. 101(b)(2), of this Act, provides:

“(2) Waiver of limitations. If refund or credit of any overpayment of tax resulting from the amendments made by this section is prevented at any time before the close of the 1-year period beginning on the date of the enactment of this Act by the operation of any law or rule of law (including *res judicata*), such refund or credit may nevertheless be made or allowed if claim therefore is filed before the close of such period.”

**Exhibit 3-13: (continued)**

In 2002, P.L. 107-358, Sec. 2, added subsec. (c) in Sec. 901 of P.L. 107-16 [see below], effective 12/17/2002.

In 2001, P.L. 107-16, Sec. 542(c), added para. (d)(9), effective for estates of decedents dying after 12/31/2009.

—P.L. 107-16, Sec. 901, of this Act [as amended by Sec. 2 of P.L. 107-358, see above], reads as follows:

“Sec. 901. Sunset of provisions of Act.

“(a) In general. All provisions of, and amendments made by, this Act shall not apply—

“(1) to taxable, plan, or limitation years beginning after December 31, 2010, or

“(2) in the case of title V, to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010.

“(b) Application of certain laws. The Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 shall be applied and administered to years, estates, gifts, and transfers described in subsection (a) as if the provisions and amendments described in subsection (a) had never been enacted.

“(c) Exception. Subsection (a) shall not apply to section 803 (relating to no federal income tax on restitution received by victims of the Nazi regime or their heirs or estates).”

One other publication will prove to be valuable if the researcher is addressing issues that predate the 1954 Code. *Seidman's Legislative History of Federal Income Tax Laws* details the historical evolution of the early tax law. It explains how certain provisions evolved into their current form in the Code.

## INTERPRETING THE INTERNAL REVENUE CODE

One of the greatest problems for a tax researcher is the interpretation of the *Internal Revenue Code*. Often, Code provisions are long, interrelated, and confusing. For example, several sentences in the Code exceed 300 words; one of them exceeds 400 words. In researching a client's tax problem, one must read each Code section that might apply. Many times, a single phrase or clause in the section may prevent the client from being subject to the provision or may contain other unexpected implications for the client's situation.

A researcher, in his or her initial review, may find the topical index, which is included by most publishers of the Code, a useful tool in locating a starting point or the relevant Code section. In reading, interpreting, and evaluating a selected Code section, the tax researcher must be especially critical of the language used throughout the section. Many, if not most, Code sections contain a general rule, followed by specific conditions that must be satisfied in order to apply the provision, and situations under which the taxpayer is excepted from the general rule. In some cases, the exceptions to the general rule are further modified to provide for exceptions to the general exceptions. Moreover, some exceptions to a Code section are addressed not within the same section, but in another section of the Code. Therefore, all relevant provisions must be read carefully.

In addition to being aware of the required conditions for application of a section, as well as the exceptions thereto, the researcher must be aware of the defini-

tions of terms used in the section; pertinent definitions may be given within the section or in some other provision of the Code. These definitions may be significantly different from the common use of the term.

In §7701, the text defines many of the terms used throughout the Code, but these definitions may be superseded by material contained within the applicable Code section. In addition, the researcher may need to look beyond the Code, such as to the Regulations or other authority, to determine the conditions that a specific term may encompass. In all cases, the researcher should avoid jumping to premature conclusions until a thorough analysis of all relevant Code sections has been completed.

The tax researcher must be careful not to overlook words that connect phrases, such as “and” and “or.” These words have very different logical meanings, and, even when the words are “hidden” at the end of the previous clause or subparagraph, they may significantly change the outcome of a research project. The word “and” is conjunctive; the word “or” is disjunctive. If the word “and” lies between two phrases, both of them must be true for the provision to apply to the client’s problem. However, if the word “or” lies between two phrases, then only one of them must be true for the provision to apply.

The researcher also must be careful with words that modify percentage or dollar amounts. The phrases “less than 50 percent,” “more than 50 percent,” and “not less than 50 percent” have very different meanings in determining whether the provisions of a section apply. The researcher also must distinguish between such terms as “thirty days” and “one month,” because they usually identify different time periods.

**Example 3-2 Conflicting Code Sections.**

Paul is a roofing contractor and has a truck he uses 100 percent of the time in his business. The truck cost \$35,000 three years ago, and Paul has claimed cost recovery deductions of \$24,920 on the truck, which leaves him an adjusted basis of \$10,080. Paul sells the truck for \$22,080 resulting in a gain of \$12,000 on the truck. How is he to treat this gain for tax purposes?

In the *Internal Revenue Code*, Paul finds that when depreciable property used in a trade or business [§1231(b)] is sold, the gain is treated as a long-term capital gain [§1231(a)]. Thus, he might report the gain on his tax return as a long-term capital gain. However, in §1245(a), Paul discovers that gain on depreciable personal property (in this case, the truck) is ordinary income to the extent of depreciation claimed since 1961. Thus, §1245 would indicate the gain is ordinary, not long-term capital.

How is the problem resolved? In §1245(d), Paul finds a directive that the recapture provision “shall apply notwithstanding any other provision of this subtitle [of the Code].” As a result, he must report the gain as ordinary income on his tax return, not long-term capital gain.

If Paul had read only §1231 of the Code and not §1245, he would have arrived at a different conclusion about the gain. In many situations, when Code sections conflict, the resolution of the conflict may not be as easy as in this example.

When analyzing a provision that recently has been changed by Congress, a researcher must be very careful to cross-reference all of the uses of terms whose definitions have been affected by the new law. Often, Congress does not use the care necessary to ascertain that all of the “loose ends” of the new provisions have been tied up. In recent years, almost every major change in the tax law has been followed by a “technical corrections act” to remove errors in implementing and interpreting the new provisions of the law, as well as to clarify problems that arise in

integrating the new provisions with the existing provisions of the Code. Most of these corrections are identified by practitioners whose clients' situations are adversely affected by a given reading of the amended law; thus, the typical technical corrections act testifies as much to the thoroughness of the practitioners' research as to shoddy drafting of the law by Congress.

Because the provisions of the *Internal Revenue Code* change frequently, the researcher must be aware of the effective dates of the various changes to the law. A provision may not go into effect immediately upon its adoption by Congress. The date of the act with which the change in law is passed is not always indicative of the effective date of the provision. Often, various provisions under the same tax law will become effective on different dates and, in fact, may have effective dates that precede the date of the tax act. Similarly, when a provision of the tax law is deleted from the Code, the provision may be left in effect for a designated period of time before it actually expires. Transitional rules may also apply. The effective date for a change in the tax law usually may be found in the explanation of the Public Laws, which follows the pertinent Code section (see, e.g., Exhibit 3-13). In some cases, the researcher may need to look to the explanation under another Code section for the effective date of a provision. The researcher must be careful to align the client's facts with the effective law at the pertinent dates, or a serious mistake could be made in the research conclusion.

Finally, the tax researcher must be aware that not *all* of the answers to a tax question will be found in the Code. The Code may be silent concerning the problem at hand, the application of Code language to the fact situation at hand may not be clear, or Code sections may appear to be in conflict. Thus, the researcher must look for an answer from other sources, such as tax treaties, administrative rulings (see Chapter 4), judicial decisions (see Chapter 5), or secondary sources of the law (see Chapters 6 through 8). Alternatively, the controlling law may be found in other parts of the Code, such as tariff or bankruptcy laws. Exhibit 3-14 lists examples of Federal laws other than the Code that affect specific tax matters.

**Exhibit 3-14: Examples of Federal Laws Other Than the *Internal Revenue Code* That May Affect a Tax Transaction**

Administrative Procedure Act  
Alaska Native Claims Settlement Act  
Atomic Energy Act Tax Provision  
Bank Holding Company Act of 1956  
Civil Rights Attorneys' Fees Awards Act of 1976  
Financial Institutions Reform, Recovery, and Enforcement Act of 1989  
Metric Conversion Act of 1975  
Merchant Marine Act: Capital Construction Fund  
New York City Pension Act  
Organic Act of Guam

## SUMMARY

The three major sources of statutory tax law are the Constitution, tax treaties, and the *Internal Revenue Code*. The tax researcher must thoroughly understand each of these sources and the interrelationships among them. The Constitution is the basis for all Federal laws. The tax treaties are agreements between countries, negotiated by the President and approved by the Senate, that cover taxpayers subject

to the tax laws of both countries. The authority of a tax treaty may equal or exceed that of a Code section. The greatest volume of tax statutes is found in the *Internal Revenue Code*, which is Title 26 of the *United States Code*. The Code contains the tax laws that Congress has passed, and it is the basic document for most U.S. tax provisions.

## TAX TUTOR

Reinforce the tax research information covered in this chapter by completing the online tutorials located at the *Federal Tax Research* web site: <http://academic.cengage.com/taxation/raabe>

## KEY WORDS

By the time you complete this chapter, you should be comfortable discussing each of the following terms. If you need additional review of any of these items, return to the appropriate material in the chapter or consult the glossary to this text.

Committee Report  
Internal Revenue Code  
Primary authorities

Secondary authorities  
Statutory sources  
Tax treaties

## DISCUSSION QUESTIONS

1. What are the three primary statutory sources of U.S. Federal tax law?
2. Discuss the effect of *Pollock v. Farmers' Loan and Trust Co.* on the development of U.S. income tax laws.
3. The Sixteenth Amendment to the Constitution had a significant effect on the U.S. income tax. What was it?
4. Discuss briefly the events leading to the passage of the Sixteenth Amendment to the U.S. Constitution.
5. What did the U.S. Supreme Court hold in *Flint v. Stone Tracy Co.* in 1911?
6. Tax protesters who file “frivolous” tax returns or bring “frivolous” proceedings before the U.S. Tax Court are subject to certain fines or other penalties. What are the grounds for imposing each penalty? What is the maximum amount of each penalty?

7. Discuss the powers of taxation that are granted to Congress by the U.S. Constitution. Are any limits placed on the powers of Congress to so tax?
8. Have the Federal courts ever held Federal estate and gift taxes to be unconstitutional?
9. What is a tax treaty? Explain the purpose of a tax treaty. What matters generally are covered in a tax treaty?
10. How is a tax treaty terminated?
11. When an *Internal Revenue Code* section and a tax treaty provision appear to conflict, which usually prevails?
12. Describe the ratification process for a tax treaty between the United States and another country.
13. The tax researcher must be able to find descriptions of tax treaties to solve certain tax problems. List different locations where a tax researcher might find a tax treaty.
14. Briefly summarize the usual steps of the legislative process for development of Federal tax legislation.
15. As a bill proceeds through Congress, various Committee Reports are generated. List the three Committee Reports that typically are prepared for a new tax law.
16. When are Committee Reports useful to a tax researcher?
17. What is a Public Law number? In P.L. 100-203, what do the “100” and the “203” indicate?
18. Where would a tax researcher find pertinent Committee Reports? List at least four publications and their publishers that include tax-related Committee Reports. Is there an index that would help a tax researcher locate a specific Committee Report? If so, where might such an index be found?
19. In addition to the Committee Reports, which are a by-product to the development of tax legislation, what other report may be of value to the tax researcher analyzing a new provision of the tax law? Why?
20. Discuss the evolution of today’s *Internal Revenue Code*.
21. The *Internal Revenue Code* is Title 26 of the *United States Code*. How is the *Internal Revenue Code* subdivided?
22. How are the subtitles of the *Internal Revenue Code* identified? What generally is contained in a subtitle?
23. In the citation §101(a)(2)(B), what does the “a” stand for? What do the “2” and the “B” indicate to a tax researcher?
24. In the citation §1031(a)(3)(B), what does the “a” stand for? What do the “3” and the “B” indicate to a tax researcher?



25. Are there any exceptions to the general formatting rules for a Code section? Give examples.
26. In what subchapter of Chapter 1, Subtitle A are located the Code sections relating to:
  - a. corporations?
  - b. mutual funds?
  - c. tax-exempt organizations?
27. What Code section contains the statute for the definition of:
  - a. gross income?
  - b. the interest deduction?
  - c. depreciation and cost recovery?
28. The tax researcher must be careful not to overlook connecting words such as “and,” “or,” “at least,” and “more than.” Explain why this is important.
29. Not all statutory tax laws are found in the *Internal Revenue Code*. Is this statement true or false? Discuss briefly.

## EXERCISES

30. Locate the Committee Reports associated with each of the following Code sections using a tax service such as RIA Checkpoint. Give the Public Law (P.L.) number of the most recent committee for each Code section.
  - a. Section 25A
  - b. Section 117
  - c. Section 162
31. Locate the Committee Reports associated with each of the following Code sections using a tax service such as RIA Checkpoint. Give the Public Law (P.L.) number of the most recent committee for each Code section.
  - a. Section 24
  - b. Section 243
  - c. Section 222
32. Log on (<http://waysandmeans.house.gov>) to the Ways and Means Committee of the U.S. House of Representatives web site and answer the following questions.
  - a. Who is the chair of the committee?
  - b. What is the total number of members on the committee?
  - c. How many of the members are from your home state? If none, say so.
  - d. The Ways and Means Committee has several subcommittees. Name three of these subcommittees and indicate who chairs each subcommittee.
33. What is found in each of the following subtitles of the *Internal Revenue Code*?
  - a. Subtitle B
  - b. Subtitle F
  - c. Subtitle A
  - d. Subtitle C

34. Each subtitle of the *Internal Revenue Code* contains several chapters. How are chapters identified? What generally is included in a chapter of the Code?
35. Identify the general content of each of the following chapters of the *Internal Revenue Code*.
  - a. Chapter 11
  - b. Chapter 61
  - c. Chapter 1
  - d. Chapter 12
36. Chapters of the *Internal Revenue Code* are subdivided into subchapters. How are subchapters identified? What generally is contained in a subchapter?
37. Correctly cite the italicized sentence indicated by the dart (▶) in the following passage from the Code.

#### SECTION 74. PRIZES AND AWARDS

##### a. General rule

Except as otherwise provided in this section or in section 117 (relating to qualified scholarships), gross income includes amounts received as prizes and awards.

##### b. Exception for certain prizes and awards transferred to charities

Gross income does not include amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, but only if—

1. the recipient was selected without any action on his part to enter the contest or proceeding;
  2. ▶ *the recipient is not required to render substantial future services as a condition to receiving the prize or award; and*
  3. the prize or award is transferred by the payor to a governmental unit or organization described in paragraph (1) or (2) of section 170(c) pursuant to a designation made by the recipient.
38. Correctly cite the italicized sentence indicated by the dart (▶) in the following passage from the Code.

#### SECTION 263A. CAPITALIZATION AND INCLUSION IN INVENTORY COSTS OF CERTAIN EXPENSES

##### a. Nondeductibility of certain direct and indirect costs

1. In general—In the case of any property to which this section applies, any costs described in paragraph (2)—

A. in the case of property which is inventory in the hands of the taxpayer, shall be included in inventory costs, and

B. ▶ *in the case of any other property, shall be capitalized.*

2. Allocable costs

39. What is the general content of each of the following subchapters of Chapter 1, Subtitle A, of the *Internal Revenue Code*?
- a. Subchapter C
  - b. Subchapter K
  - c. Subchapter S
  - d. Subchapter E

40. What is found in each of the following subchapters of Subtitle A, Chapter 1 of the *Internal Revenue Code*?
  - a. Subchapter B
  - b. Subchapter E
  - c. Subchapter L
  - d. Subchapter F
41. Which subchapter of Subtitle A, Chapter 1 of the *Internal Revenue Code* contains the provisions related to:
  - a. Deferred Compensation
  - b. Partners and Partnerships
  - c. Corporate Distribution and Adjustments
  - d. Banks
42. Which *Internal Revenue Code* sections are found in each of these subchapters of Subtitle A, Chapter 1?
  - a. Subchapter J
  - b. Subchapter A
  - c. Subchapter I
  - d. Subchapter P
43. Which *Internal Revenue Code* sections are found in each of these parts of Subtitle A?
  - a. Subchapter A, Part IV
  - b. Subchapter C, Part II
  - c. Subchapter B, Part VIII
  - d. Subchapter A, Part I
44. What is covered in Subtitle A, Chapter 2 of the *Internal Revenue Code*? What *Internal Revenue Code* sections are included in Chapter 2?
45. What is found in each of the following subchapters of Chapter 1, Subtitle A, of the *Internal Revenue Code*?
  - a. Subchapter D
  - b. Subchapter H
  - c. Subchapter P
  - d. Subchapter L
46. What is the official name of P.L. 108-27? What year was that law enacted? Where did you find your answer?
47. What is the official name of P.L. 99-514? What year was that law enacted? Where did you find your answer?
48. The most important division of the *Internal Revenue Code* is the section. Sections usually are subdivided into various smaller elements. Name several of these elements and state how they are denoted.
49. Do section numbers repeat themselves or is each one unique?
50. Identify the general contents of each of the following *Internal Revenue Code* sections.
  - a. §61
  - b. §162

- c. §1
  - d. §212
51. Identify the general contents of each of the following *Internal Revenue Code* sections.
- a. §62
  - b. §163
  - c. §11
  - d. §164
52. Locate Section 217 of the Code. It is found in the:
- a. Subtitle of the Code
  - b. Chapter
  - c. Subchapter
  - d. Part
53. Locate Section 2036 of the Code. It is found in the:
- a. Subtitle of the Code
  - b. Chapter
  - c. Subchapter
  - d. Part
54. Use a tax service (e.g., RIA Checkpoint, Lexis, Westlaw, etc.) to answer the following questions.
- a. Which service did you use?
  - b. What is the general content of *Internal Revenue Code* §28?
  - c. What is the general content of *Internal Revenue Code* §141?
  - d. What is the general content of *Internal Revenue Code* §166?
  - e. Print a copy (maximum of one page) of any one of the above Code sections and attach it to your answer.
55. Use a tax service (e.g., RIA Checkpoint, Lexis, Westlaw, etc.) to answer the following questions.
- a. Which tax service did you use?
  - b. What is the general content of *Internal Revenue Code* §117?
  - c. What is the general content of *Internal Revenue Code* §165?
  - d. What is the general content of *Internal Revenue Code* §304?
  - e. Print a copy (maximum of one page) of any one of the above Code sections and attach it to your answer.
56. Use a tax service (e.g., RIA Checkpoint, Lexis, Westlaw, etc.) to answer the following questions.
- a. Which tax service did you use?
  - b. What is the general content of *Internal Revenue Code* §25A?
  - c. What is the general content of *Internal Revenue Code* §67?
  - d. What is the general content of *Internal Revenue Code* §280G?
  - e. Print a copy (maximum of one page) of any one of the above Code sections and attach it to your answer.
57. Name several locations where a tax researcher would find the text of the current *Internal Revenue Code*.

58. If a tax researcher wants to know if there is an equivalent 1939 Code section for a specific 1986 Code section, how would he or she locate it?
59. One important problem that faces a tax researcher is interpretation of the *Internal Revenue Code*. Comment on each of the following interpretation problems.
- Exceptions to a Code section
  - Words that connect phrases, such as “and” and “or”
  - Recent changes in the Code
  - Effective dates
  - Words that modify percentages, dollar amounts, or time
60. Comment on the statement, “All tax questions can be answered using the *Internal Revenue Code*.”
61. Does the United States have an income tax treaty with any of the following countries? If it does, in what year was the treaty signed? State where you found this information.
- Japan
  - United Kingdom
  - Egypt
  - Germany
62. Does the United States have an estate tax treaty with any of the following countries? If it does, in what year was the treaty signed? State where you found this information.
- Canada
  - Finland
  - Hungary
  - Italy
63. Does the United States have an estate tax treaty with any of the following countries? If it does, in what year was the treaty signed? State where you found this information.
- Ukraine
  - Brazil
  - Kenya
  - Kazakhstan
64. Use a tax service (e.g., RIA Checkpoint, Lexis, Westlaw, etc.) to locate §117 of the *Internal Revenue Code*. Answer the following questions.
- Which tax service did you use?
  - How many subsection(s) does §117 include?
  - How many paragraph(s) does §117(b) include?
  - How many subparagraph(s) does §117(d)(2) include?
  - Print a copy (maximum of one page) of this section and attach it to your answer.
65. Use a tax service (e.g., RIA Checkpoint, Lexis, Westlaw, etc.) to locate §385 of the *Internal Revenue Code*. Answer the following questions.
- Which tax service did you use?
  - How many subsection(s) does §385 include?

- c. How many paragraph(s) does §385(b) include?
  - d. Print a copy (maximum of one page) of this section and attach it to your answer.
66. Use a tax service (e.g., RIA Checkpoint, Lexis, Westlaw, etc.) to locate §280C of the *Internal Revenue Code*. Answer the following questions.
  - a. Which tax service did you use?
  - b. How many subsection(s) does §280C include?
  - c. How many paragraph(s) does §280C(b) include?
  - d. How many subparagraph(s) does §280C(b)(2) include?
  - e. Print a copy (maximum of one page) of this section and attach it to your answer.
67. When was each of the following sections originally enacted? State how you obtained this information.
  - a. §843
  - b. §131
  - c. §469
  - d. §263A
68. In which subtitle, chapter, and subchapter of the 1986 Code are each of the following sections found?
  - a. §32
  - b. §172
  - c. §2039
  - d. §6013
69. List the first three section numbers and titles of each of the following subchapters of Chapter 1 of the *Internal Revenue Code*.
  - a. Subchapter B
  - b. Subchapter E
  - c. Subchapter J
  - d. Subchapter S
70. Identify the equivalent section of the current Code for each of the following sections of the 1939 Code. If there is no equivalent section, say so.
  - a. §1
  - b. §113(a)
  - c. §22(a)
  - d. §115(a)
  - e. §181
71. Use a computer tax service (e.g., RIA Checkpoint, Lexis, Westlaw, etc.) to locate the following Code sections. What other Code sections reference each of the sections you found? State which computer tax service you used to complete this assignment.
  - a. §72
  - b. §307
  - c. §446
72. Name the article and section of the U.S. Constitution that gives Congress the power to levy a tax.

73. Enumerate the Code sections that contain the chief tax law provisions on the following topics.
  - a. S corporations
  - b. Personal holding company tax
  - c. Gift tax
  - d. Tax accounting methods
74. Use a nonsubscription Internet site to determine how many Senators are on the Senate Finance Committee. Who is the Chair of the Finance Committee? State where you found this information.
75. Use a nonsubscription Internet site to determine how many Representatives are on the House Ways and Means Committee. Who is the Chair of the Ways and Means Committee? State where you found this information.
76. Use a nonsubscription Internet site to determine what is contained in each of the following. State where you found this information.
  - a. U.S. Const. art. I, §9 cl. 3
  - b. U.S. Const. art. I, §8 cl. 1
  - c. U.S. Const. art. II, §2 cl. 2
77. Locate and print the first page of a House Ways and Means Committee Report using only a nonsubscription Internet site. State where you found this information.

## RESEARCH CASES

78. Private G.I. Jane was a soldier in the Iraq War. Her salary was \$1,800 per month, and she was in the war zone for eight months. How much of her salary is taxable for the eight months? In answering this case, use only the *Internal Revenue Code* for your research. *Computer search keywords*: combat, pay, officers, enlisted
79. Carol received a gift of stock from her favorite uncle. The stock had a fair market value of \$30,000 and a basis to the uncle of \$10,000 at the date of the gift. How much is taxable to Carol from this gift? In answering this case, use only the *Internal Revenue Code* for your research. *Computer search keywords*: gift, gross income, exclusion
80. Maria is an independent long-haul trucker. She receives a speeding ticket for \$500, which she pays. Can Maria deduct the ticket on Schedule C? In answering this case, use only the *Internal Revenue Code* for your research. *Computer search keywords*: fines, penalties, deduction
81. Julie loaned her friend Nathan \$2,500. Nathan did not repay the debt and skipped town. Can Julie claim any deduction? In answering this case, use only the *Internal Revenue Code* for your research. *Computer search keywords*: loss, bad debt, worthless
82. In December of 20x1, Ann's twelve-year-old cousin, Susan, came to live with her after Susan's parents met an untimely death in a car accident. In 20x2, Ann provided all normal support (e.g., food, clothing, education) for Susan. Ann

did not formally adopt Susan. If Susan lived in the household for the entire year, can Ann claim a dependency exemption for her cousin for the tax year? In answering this case, use only the *Internal Revenue Code* for your research. *Computer search keywords:* dependent, household, support

83. John and Maria support their twenty-one-year-old son, Bill. The son earned \$10,500 last year working in a part-time job. Bill went to college part time in the spring semester of the current year. To complete his degree, Bill started school full time in the fall. The fall semester at Bill's college runs from August 20 to December 20. Can John and Maria claim Bill as a dependent on the current year's tax return, even if Bill earns this level of gross income? Assume any dependency test not mentioned has been met. In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.
84. George and Linda are divorced and own a house from the marriage. Under the divorce decree, Linda pays George \$3,000 per month alimony. Since the real estate market has collapsed in the area where they live, George and Linda cannot sell the house. Since they are still friends, they decide to live in separate wings of the house until the real estate market recovers. If George and Linda live together for the entire current year, can Linda claim a deduction for the alimony paid to George? In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.
85. Juan sold IBM stock to Richard for a \$10,000 loss. Richard is the husband of Juan's sister, Carla. How much of the loss can Juan deduct in the current year if Juan's taxable income is \$55,000 and he has no other capital transactions? In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.
86. Tex is a rancher. This year her herd of cattle was infested with hoof-and-mouth disease and had to be destroyed. Tex's insurance policy reimburses her for an amount in excess of the tax basis in the cattle, thereby creating an "insurance gain." After receiving the insurance proceeds, Tex buys a new herd of cattle. Can Tex defer the recognition of this insurance gain on the destroyed herd? In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.
87. Betty owed Martha \$5,000. In payment of this debt, Betty transferred to Martha a life insurance policy on Betty, with a cash surrender value of \$5,000. The face value of the policy is \$100,000. Martha names herself as beneficiary of the policy and continues to make the premium payments. After Martha has paid \$15,000 in premiums, Betty dies and Martha collects \$100,000. Is any of the \$100,000 Martha received taxable? In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.
88. On May 1, Rick formed a new corporation, Red, Inc. He spent \$3,000 in legal fees and paid the state \$600 in incorporation fees to set up Red Corporation.



Red Corporation started operating its business on May 10. Can Rick or Red Corporation deduct either of these organizational fees? In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.

89. This year, there were massive brush fires in the interior of Mexico. Amy gave \$10,000 to the Mexican Relief Foundation, which is organized in Mexico City. The funds were used to provide food, clothing, and shelter to the victims of the Mexican fires. Is Amy's charitable contribution deductible for income tax purposes? In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.
90. Curtis is fifty years old and has an IRA with substantial funds in it. His son, Curtis, Jr., was accepted to Yale University upon graduating from high school. Curtis had not planned for this and needs to draw \$25,000 per year out of his IRA to help pay the tuition and fees at Yale. What are the tax consequences of the withdrawals from the IRA? In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.
91. Cathy Coed is a full-time senior student at Big Research University (BRU). Cathy is considered by most as a brilliant student and has been given a \$35,000 per year scholarship. In the current year, Cathy pays the following amounts to attend BRU:

Tuition	\$26,000
Required Lab Fees	\$300
Required Books and Supplies	\$1,000
Dorm Fees	\$7,500

What are the tax consequences (i.e., how much is income) of the \$35,000 current year's scholarship to Cathy? In answering this case, use a computer tax service with only the *Internal Revenue Code* database selected. State your keywords and which computer tax service you used to arrive at your answer.

92. Dennis is an executive of Gold Corporation. He receives a one-for-one distribution of stock rights for each share of common stock he owns. On the date of distribution the stock rights have a fair market value of \$2 per right and the stock has a fair market value of \$20 per share. Dennis owns 10,000 shares of the stock with a basis of \$5 per share. If Dennis does not make any special elections with regard to the stock rights, what is his basis in the rights?
- Locate the Code section(s) that deals with this situation. State the section number(s).
  - Review the Code section(s). Does it raise a need for new information to solve this question?
  - Are you able to reach a conclusion about the research question from this Code section? If so, what is your conclusion(s)?
93. Kurt purchased a new Toyota hybrid automobile that gets 50 miles per gallon of gasoline. Determine if Kurt gets any special Federal tax breaks for purchasing this energy-saving car. If so, how are such tax breaks calculated?

- a. Locate the Code section(s) that deals with this situation. State the section number(s).
  - b. Review the Code section(s). Does it raise a need for new information to solve this question?
  - c. Are you able to reach a conclusion about the research question from this Code section? If so, what is your conclusion(s)?
94. Monica purchased two acres of land with an old building on it for \$1,000,000. The purchase was made to acquire the land for a new store she wanted to open on the property. Shortly after completing the purchase, Monica pays \$80,000 to have the old building demolished. How does Monica treat the \$80,000 demolition payment for tax purposes?
- a. Locate the Code section(s) that deals with this situation. State the section number(s).
  - b. Review the Code section(s). Does it raise a need for new information to solve this question?
  - c. Are you able to reach a conclusion about the research question from this Code section? If so, what is your conclusion(s)?
95. Lihue, Inc. sells timeshares in Hawaii. Gene buys a timeshare out of the inventory of timeshares for sale by Lihue, Inc. Gene agrees to pay them \$10,000 down and Lihue, Inc. will finance a seven-year note for the balance of the purchase price at the current market rate of interest. Can Lihue, Inc. use the installment method to report their gain on the sale of the Hawaiian timeshare to Gene?
- a. Locate the Code section(s) that deals with this situation. State the section number(s).
  - b. Review the Code section(s). Does it raise a need for new information to solve this question?
  - c. Are you able to reach a conclusion about the research question from this Code section? If so, what is your conclusion(s)?
96. Sara Student is a full-time freshman at Small State University (SSU). Her tuition for the year is \$42,000, which is paid by Sara's mother, Susan. Sara also has a job earning substantial money as a model; therefore, Sara does not qualify as Susan's dependent. Can Sara's mother claim the HOPE Education credit for the tuition she paid? Can Sara claim the HOPE credit on any unused portion of the tuition?
- a. Locate the Code section(s) that deals with this situation. State the section number(s).
  - b. Review the Code section(s). Does it raise a need for new information to solve this question?
  - c. Are you able to reach a conclusion about the research question from this Code section? If so, what is your conclusion(s)?