

The tax research process

[Economics](#), [Tax](#)



The Tax Research Process The overriding purpose of tax research is to find solutions to the tax problems of one's clients or employer. The process is similar to that of traditional legal research. The researcher must find authority, evaluate the usefulness of that authority, and apply the results of the research to a specific situation. One can identify two essential tax research skills: * The first is using certain mechanical techniques to identify and locate the tax authorities that relate to solving a problem. * The second entails a combination of reasoning and creativity and is more difficult to learn.

A researcher must begin with native intelligence and imagination and add training and experience properly to apply the information found. Creativity is necessary to explore the relevant relationships among the circumstances and problems at hand to find a satisfying (and defensible) solution. In many cases, no legal authority exists that is directly on point for the problem. If such a situation comes up, the researcher must combine seemingly unrelated facts, ideas (including those that he or she has derived from previous research work), and legal authority to arrive at a truly novel conclusion.

This creative ability of the researcher often spells the difference between success and failure in the research process. Outline of Tax Research Process As the tax problems of the client become more significant, the related tax research can become time-consuming and, thus, expensive to the client. A moderate tax research problem often takes up to eight or ten hours of research time, and the bill for these services may approach or even exceed

\$2, 000. Because of the costs that are involved, the tax researcher must work as efficiently as possible to obtain the solution to the client's problem.

The researcher needs a framework for the research process, so that he or she does not waste time and effort in arriving at a solution to the problem. The tax research process can be broken down into six major steps. Tax researchers (especially those without a great amount of experience at the task) must approach the resolution of a tax problem in a structured manner, so that the analysis of the problem will be thorough and the solution complete. Step 1: Establish the Facts Before a researcher can analyze the tax consequences of a transaction, he or she must understand the transaction itself.

Specifically, the researcher should discuss the details of the transaction with the client to ascertain the client's motivation. What are the client's business or financial objectives in undertaking the transaction? What does the client foresee as the desired outcome? What risks has the client identified? By asking these types of questions, the researcher gets to be more acquainted with the non-tax features of the transactions. Discover All the Facts The researcher must discover all the facts concerning the client's transaction.

Like a newspaper reporter, the researcher should question the client about the precise " who, when, where, why, and how" of the transaction. The researcher should not assume that the client's initial summary of the transaction is factually accurate and complete. Perhaps the client hasn't determined all the facts that the researcher needs. Or the client may have discounted the significance of certain facts and omitted them from the initial

summary. The researcher should encourage the client to be objective in stating the facts.

Often, a client unwittingly presents the researcher with the client's subjective conclusions about the facts rather than with the facts themselves.

Impact of Client's Tax Knowledge When a researcher is working with a client to uncover the relevant facts, the researcher must take into account the level of the client's tax knowledge. If the client has some knowledge of the tax law, the researcher can ask questions that presume such knowledge. On the other hand, if the client is unsophisticated in tax matters, the researcher should ask only questions that the client can answer without reference to the tax law.

Step 2: Identify the Issues After the researcher is satisfied that he or she understands the client's transaction and knows all the relevant facts, the researcher can proceed to the second step in the research process. In this step, the researcher identifies the tax issue or issues suggested by the transaction. The ability to recognize tax issues is the product of technical education and professional experience. Consequently, this step is usually the most challenging for new tax researchers. The identification of issues leads to the formation of tax research questions.

The tax researcher should be as precise as possible in formulating questions. A precise question is narrowly stated and provides clear parameters for the remaining steps in the research process. An imprecise question that is vague or overly broad in scope may provide insufficient parameters and result in wasted time and effort.

Multiple Research Questions If the tax issue suggested by a transaction lead to multiple research questions, the

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researcher must determine the order in which the questions should be answered.

In our complex tax system, the answer to a question often depends on the answer to one or more preliminary questions. Tax researchers who understand the hierarchy of their research questions can address each question in the right order and conduct their research with maximum efficiency. A combination of education, training, and experience is necessary to enable the researcher to identify all of the issues with respect to a tax problem successfully. In some situations, this step can be the most difficult element of a tax research problem to carry out.

Issues in a closed-fact tax research problem often arise from a conflict with the IRS. In such a case, one can ascertain the issue(s) easily. Research of this nature usually consists of finding support for an action that the client has already taken. Types of Issues In most research projects, however, the researcher must develop a list of issues. Research issues can be divided into two major categories: * Fact issues are concerned with information having an objective reality, such as the dates of transactions, the amounts involved in an exchange, reasonableness, intent, and purpose. Law issues arise when the facts are well established, but it is not clear which portion of the tax law applies to the issue. Step 3: Locate Authority As the third step in the research process, the researcher heads for a tax library. A researcher's mission is to locate the authority that provides answers to the research question. Traditional libraries consist of shelves filled with books, loose-leaf binders, magazines, and other published materials containing all the technical minutiae of the tax law.

Today, traditional libraries are disappearing as professional tax advisors gain access to the electronic libraries available on the Internet. One obvious advantage of electronic libraries is the speed at which researchers can access sources of authority and move among the sources. A second advantage is the ease with which electronic sources can be updated to include current developments. A third advantage is that an electronic library is portable. A tax researcher with a laptop computer can access the library at any time and from any location.

Regardless of whether a tax researcher is working in a traditional or electronic library, a researcher must be knowledgeable about the content and organization of the reference pertaining to the problem at hand. The researcher also must be able to distinguish between the two main categories of reference materials: sources of authority and sources of information. **Primary Authority** Primary authority is an element of the Federal tax laws that was issued by Congress, the Treasury Department, or Internal Revenue Service. Primary authority carries greater precedential weight than secondary authority.

Each primary authority also has a relative weight to other primary authorities. Weight is best described as an assessment of relative importance compared to other authority. Statutory sources include the Constitution, tax treaties, and tax laws passed by Congress. Statutory authority is the basis for all tax provisions. The Constitution grants Congress the power to impose and collect taxes and also authorizes the creation of treaties with other countries. The power of Congress to implement and

collect taxes is summarized in the Internal Revenue Code, the official title of U. S. tax law.

The Internal Revenue Code constitutes the basis for all tax law, and, therefore, the basis for arriving at solutions to all tax questions. The other primary sources of the tax law, administrative and judicial authority, function primarily to interpret and explain the application of the provisions of the Internal Revenue Code and the intent of Congress. Administrative sources include the various rulings of the Treasury Department and the IRS. These are issued in the form of Regulations, Revenue Rulings, and other pronouncements. Judicial sources consist of collected rulings of the various courts on federal tax matters.

Secondary Authority Secondary Authority Sources consist of unofficial sources of tax information, such as: * tax services * journals * textbooks * treatises * newsletters. Secondary authority is an element of the tax law that was issued by a professional or scholarly writer. It is an interpretation of the tax law issued by primary sources. Many secondary sources exist. Some of the most useful are the editorial analysis and explanation contained in many of the major tax services, articles published in the numerous professional journals and newsletters, treatises, and textbooks.

Secondary authority carries less precedential weight than primary authority. Secondary authorities are useful in finding, analyzing, and evaluating primary authorities. The distinction between primary and secondary (or editorial) sources of authority is more important because of IRC § 6662, which imposes a penalty on substantial understatements of tax, except where the taxpayer has "substantial authority" for the position taken on the

return. Substantial Authority The Regulation under § 6662 specifies the sources of "substantial authority" to include: * provisions of the Internal Revenue Code temporary and final Regulations * court cases * administrative pronouncements * tax treaties * Congressional intent as reflected on Committee Reports. This list was expanded by the Committee Report for the Revenue Reconciliation Act of 1989 to include: * Proposed Regulations * Private Letter Rulings * Technical Advice Memoranda, * Information or Press Releases * Notices * Any other similar documents published by the IRS in the Internal Revenue Bulletin. Treatises and articles in legal periodicals, however, are not considered substantial authority under this statute.

Conflicting Authority Secondary authority is useful when conflicting primary authority exists, when there appears to be no extant primary authority, or when the researcher needs an explanation or clarification of the primary authority. Over the past 15 years, as the support staffs of government agencies and (especially) Federal courts have been decreased in number or otherwise become inadequate, more dependence has been placed upon the secondary authorities of the tax law, even by the IRS, the Treasury Department, and the court system.

Tax researchers must be careful, though, not to rely too heavily upon secondary authority and always to read any pertinent primary authority that is referred to in the secondary sources. Commercial Tax Services Because of the vast amount of tax authority that is available, the tax researcher would have a tremendous problem in undertaking a tax research problem for a client if it were not for commercial tax services and treatises.

Several publishers have produced coordinated sets of reference materials, such as RIA's Checkpoint, that organize the tax authority into a usable format, making the Internal Revenue Code and other primary authorities much more accessible. Checkpoint® Commercial tax services, such as RIA's Checkpoint, are useful in that they provide simplified explanations with footnote citations, as well as examples illustrating the application of the law. Checkpoint leads the tax researcher, via the footnote references, to the primary source that is pertinent to the question at hand.

A tax service can be classified as chiefly an annotated service or as a topical service. Annotated services are organized in Internal Revenue Code section order, such as RIA's United States Tax Reporter. A topical service, such as RIA's Federal Tax Coordinator, is organized by topical areas determined by the editors. Step 4: Evaluate Authority Regardless of whether a researcher is reading from a printed page or a computer screen, the researcher must have the skill to interpret and evaluate the authority at hand. In some cases, the authority may provide an unambiguous answer to the researcher's question.

In other cases, the answer may be equivocal because the authority is inconclusive or subject to interpretation. Or perhaps different sources of authority provide conflicting answers. In these cases, the researcher must bring his or her own judgment to bear in analyzing the authority and answering the question. Weighting Authorities All tax authority does not carry the same precedential value. For example, the tax court could hold that an item should be excluded from gross income at the same time that an outstanding IRS Revenue Ruling asserts the item is taxable.

The tax researcher must evaluate the two authorities and decide whether to recommend that his or her client report the disputed item. How Research Can Loop In the process of evaluating the authority for the issue(s) under research, new issues previously not considered by the researcher may come to light. If this is the case, the researcher may be required to gather additional facts, find additional pertinent authority, and evaluate the new issues. All of these research activities must be related to the client's research problem.

The researcher uses professional judgment in selecting issues and determining the effort to expend on the issues. This loop is illustrated below:

Step 5: Develop Conclusions As part of the analytic process, the researcher should decide if the authority requires him or her to make a factual judgment or an evaluative judgment. **Factual Judgment** In making a factual judgment, the researcher compares the authority to a set of facts. Assuming that the facts are complete and accurate, the researcher can provide a definitive answer to the research question.

Evaluative Judgment Researchers are required to make evaluative judgments when the relevant authority relates to a conclusion inferred from a set of facts, rather than to the facts themselves. By definition, conclusions are subjective; different observers may draw different conclusions from the same facts. A researcher who must draw a conclusion to complete a research project can never be sure that such conclusion will go unchallenged by the IRS. Therefore, the researcher should never give an unqualified answer to a research question requiring an evaluative judgment.

Getting All the Facts At some point in the research process, even an expert may discover that he or she does not have all the facts necessary to complete the analysis of the client's transaction. In such case, the researcher must repeat Step 1 by obtaining additional information from the client. Oftentimes the additional information suggests additional tax issues and research questions that the researcher must address. A researcher may have to repeat Steps 1 through 4 several times before he or she is satisfied with the analysis.

Handling Unresolved Issues

Where unresolved issues exist, the researcher might inform the client about alternative possible outcomes of each disputed transaction, and give the best recommendation for each. If the research involved an open fact situation, the recommendation might detail several alternative course of future action, (for example, whether to complete the deal, or how to document the intended effects of the transaction). In many cases, the researcher may find it appropriate to present his or her recommendation of the "best" solution from a tax perspective, as well as one or more alternative recommendations that may be much more workable solutions.

In any case, the researcher will want to discuss with the client the pros and cons of all reasonable recommendations and the risks associated with each course of action.

Step 6: Communicate

The final step in the research process is to communicate the results and recommendations of the research. The results of the research effort usually are summarized in a memorandum to the client file and a letter to the client. Both of these items usually contain a restatement of the pertinent facts as the researcher understands them, any

assumptions the researcher made, issues addressed, the applicable authority, and the tax researcher's recommendations.

The memorandum to the file usually contains more detail than does the letter to the client. Client's Tax Knowledge In any event, the researcher must temper his or her communication of the research results so that it is understandable by the intended reader. For instance, the researcher should use vastly different jargon and citation techniques in preparing an article for the Journal of Taxation than in preparing a client memo for a businessperson or layperson who is not sophisticated in tax matters.