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Tax Research Methodology: A Practical Guide to Perfecting Your Tax Research Techniques  
and Achieving Sustainable Tax Return Filing Positions

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## Introduction

In order to maximize your accounting firm's overall efficiency, effectiveness, and productivity in connection to researching and resolving a tax issue and determining the sustainability of the tax return filing position, the appropriate tax research processes must be meticulously designed, implemented, and executed. The subsequent five comprehensive steps will guide you in establishing an all-inclusive tax research effort on behalf of your entire client base while properly ascertaining the likelihood of success should a tax position(s) taken on a tax return be challenged by the Internal Revenue Service (hereinafter the "Service") upon examination.

## Tax Research Methodology

### *Establish the Facts and Circumstances*

The first step in the tax research process is to establish all of the facts and circumstances provided by your client in order to determine which tax laws(s) apply to your client's fact pattern. At this initial stage, it is imperative not to omit nor overlook any of your client's facts and circumstances whether appearing material or immaterial. Always be guided by the axiom that facts and circumstances appearing to be immaterial individually may, in fact, be material in the aggregate.

### *Determine All the Issues*

The second step in the tax research process entails determining all of the tax issues affecting your client's specific facts and circumstances and any and all mitigating factors. Normally, complex tax issues evolve through several stages of development. For instance an experienced tax professional, based upon his or her prior knowledge of the tax laws, can normally determine most of the initial pertinent issues in terms of general tax laws. However, after performing an initial search of the authorities to answer the initial issues, a tax professional often discovers that one or more additional specific technical questions of interpretations must be resolved before the initial issues can be fully addressed. Consequently, at this stage, a tax professional may also encounter the need to obtain additional facts from the client. Accordingly, the tax research process may have to move back from step two to step one. In addition, you the tax professional may learn at this stage that facts initially not considered to be important may in fact prove critical to the resolution of all of your client's tax issues.

### *Identify Statutory, Administrative, and Judicial Authority*

The third step in the tax research process entails identifying the specific authorities to support all of your client's tax issues while appropriately weighing authorities that may be contrary to your supporting position. Generally, this process begins with consulting

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statutory authority (e.g., the Internal Revenue Code) and quickly expands to encompass administrative authority (e.g., Proposed Treasury Regulations, Temporary Treasury Regulations, Final Treasury Regulations, Revenue Rulings, Revenue Procedures, Private Letter Rulings, Technical Advice Memorandum, General Counsel Memorandum, Circular 230, Internal Revenue Manual, Internal Revenue Bulletins, IRS Field Service Advice Memorandum, IRS Determination Letters, and IRS Notices) and judicial authority (e.g., decisions by the U.S. Tax Court, U.S. District Court, U.S. Court of Federal Claims, U.S. Circuit Court of Appeals, U.S. Court of Appeals for the Federal Circuit, and the U.S. Supreme Court). In addition, at times, you the tax professional may have to consult the legislative history (e.g., the Public Laws and Congressional Committee Reports from the House of Representatives and the Senate) of a particular Internal Revenue Code section to fully address what Congress's intent was in passing a particular bill. Lastly, you may also want to consult the voluminous range of editorial interpretations (e.g., Tax Treatises, Tax Journals, etc.) available to assist in the interpretation a particular tax issue. However, it must be duly noted that editorial interpretations are generally impressive sources of authority before the Service and the judicial system. For clarification purposes, the subsequent synopsis will elaborate upon the aforementioned statutory, administrative, and judicial interpretations:

## **Statutory Authority**

### ***The Internal Revenue Code***

All federal level tax statutes passed by Congress into law are compiled and published in Title 26 of The United States Code. As it should be recalled, Title 26 of The United States Code contains the specific statutes that authorize the Service to collect taxes for the federal government. Generally, the tax research process begins with consulting the Internal Revenue Code and quickly expands to encompass administrative and judicial authorities based upon the complexity of the tax issue under analysis.

## **Administrative Authority**

### ***The Treasury Regulations***

The Treasury Regulations provide the official interpretations of the Internal Revenue Code by the Treasury Department and have the force and effect of law. The most common forms of Treasury Regulations include:

- ▶ **Proposed Treasury Regulations** (e.g., binding only on the IRS and not the taxpayers);
- ▶ **Temporary and Final Treasury Regulations** (e.g., binding on both the IRS and the taxpayers); and
- ▶ **Preambles** (e.g., treated just like legislative histories to demonstrate congressional intent and may underlie either type of the aforementioned treasury regulations regardless of status as Proposed, Temporary, or Final).

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### ***Revenue Rulings***

A Revenue Ruling is an official interpretation by the Service of the tax laws. Initially, Revenue Rulings are published in the weekly Internal Revenue Bulletin. The same rulings later appear in the permanently bound Cumulative Bulletin, a semi-annual publication of the Government Printing Office. Revenue Rulings hold less weight than the Treasury Regulations because they are intended to cover only specific fact patterns. Regardless, Revenue Rulings can provide valid precedent but only if your client's facts and circumstances are substantially identical.

### ***Revenue Procedures***

A Revenue Procedure is a statement of procedure that affects the rights or duties of taxpayers or other members of the public under the Code. Similar to Revenue Rulings, Revenue Procedures are less authoritative than Treasury Regulations. However, Revenue Procedures should be binding on the Service and may be relied upon by taxpayers.

### ***Private Letter Rulings***

Private Letter Rulings (hereinafter "PLR") are issued directly to taxpayers who formally request and pay for advice about the tax consequences applicable to a specific business transaction. Such PLR request have been employed frequently by either taxpayers themselves or the taxpayer's representatives (e.g., a taxpayers' representation through a CPA Firm or Law Firm) to assure themselves of a preplanned tax result before they consummate a transaction and as a subsequent aid in the preparation of the tax return's filing position. When the IRS issues a PLR it is understood that the PLR is limited in scope and application to the taxpayer making the request.

### ***Technical Advice Memorandum***

A Technical Advice Memorandum (hereinafter "TAM") is a special after-the-fact ruling that may be requested from the taxpayer or the technical staff of the Service. For instance, if a disagreement arises in the course of an audit between the taxpayer or the taxpayer's representative and the revenue agent, either side may request formal technical advice on the issue(s) through the District Director. Under certain circumstances, TAM's can be used as a basis for the issuance of a Revenue Ruling and can also be subsequently published as a PLR.

### ***General Counsel Memorandum***

General Counsel Memorandum (hereinafter "GCM") are legal memorandum that are prepared by the IRS Chief Counsel's Office. GCM's analyze proposed Revenue Rulings, Private letter Rulings, and Technical Advice Memorandum. GCM's that were issued after 1981 constitute substantial authority for purposes of the penalty assessed for the substantial understatement of income tax.

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### ***Circular 230***

Circular 230 is an IRS publication that sets forth the requirements and responsibilities of professionals (e.g., Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries) admitted to practice before the Service.

### ***Internal Revenue Manual***

The Internal Revenue Manual (hereinafter “IRM”) is an official compilation of policies, procedures, instructions, and guidelines for the organization, function, operation and administration of the Service. It is not legally binding and the policies are not mandatory. The IRM guidelines do not confer any rights on taxpayers.

### ***IRS Field Service Advice***

IRS Field Service Advice (hereinafter “FSA”) are taxpayer specific rulings furnished by the IRS National Office in response to requests made by the taxpayers or IRS Officials.

### ***IRS Determination Letters***

A Determination Letter is issued by the IRS at the taxpayer’s request to outline the Service’s position on a particular transaction that has already been completed. Generally, Determination Letters are issued only when a determination can be made on the basis of clearly established rules in the statute or regulations.

### ***IRS Notices***

When prompt guidance concerning an item of the tax law is needed, the IRS publishes notices in the Internal Revenue Bulletin. These notices are intended to be relied upon by the taxpayers to the same extent as a Revenue Ruling or Revenue Procedure.

## **Judicial Authority**

### ***U.S. Tax Court***

The U.S. Tax Court is an independent 19 judge federal administrative agency that functions as a court to hear appeals by taxpayers from adverse administrative decisions by the Service.

### ***U.S. District Court***

The U.S. District Court hears civil actions against the United States for the recovery of any tax alleged to have been erroneously or illegally assessed or collected by the Service. Trial by jury is available at the preference of either the petitioner or defendant.

### ***U.S. Court of Federal Claims***

The U.S. Court of Federal Claims is a Washington D.C. based appellate-level court in which a taxpayer may sue the government for a refund of overpaid taxes.

### ***U.S. Circuit Court of Appeals***

The U.S. Court of Appeals is one of thirteen courts including the District of Columbia and the Federal Circuit Courts, to which appeals from a trial court, such as the U.S. Tax Court, are directed.

### ***U.S. Court of Appeals for the Federal Circuit***

The U.S. Court of Appeals for the Federal Circuit hears appeals from the U.S. Court of Federal Claims.

### ***U.S. Supreme Court***

The U.S. Supreme Court is the highest appellate court in the federal court system and in most states. The U.S. Supreme Court, under its certiorari procedure authority, reviews the constitutionality of a tax law and a small number of tax decisions by the Court of Appeals.

The subsequent chart illustrates the geographic boundaries of The United States Courts of Appeals and The United States District Courts:

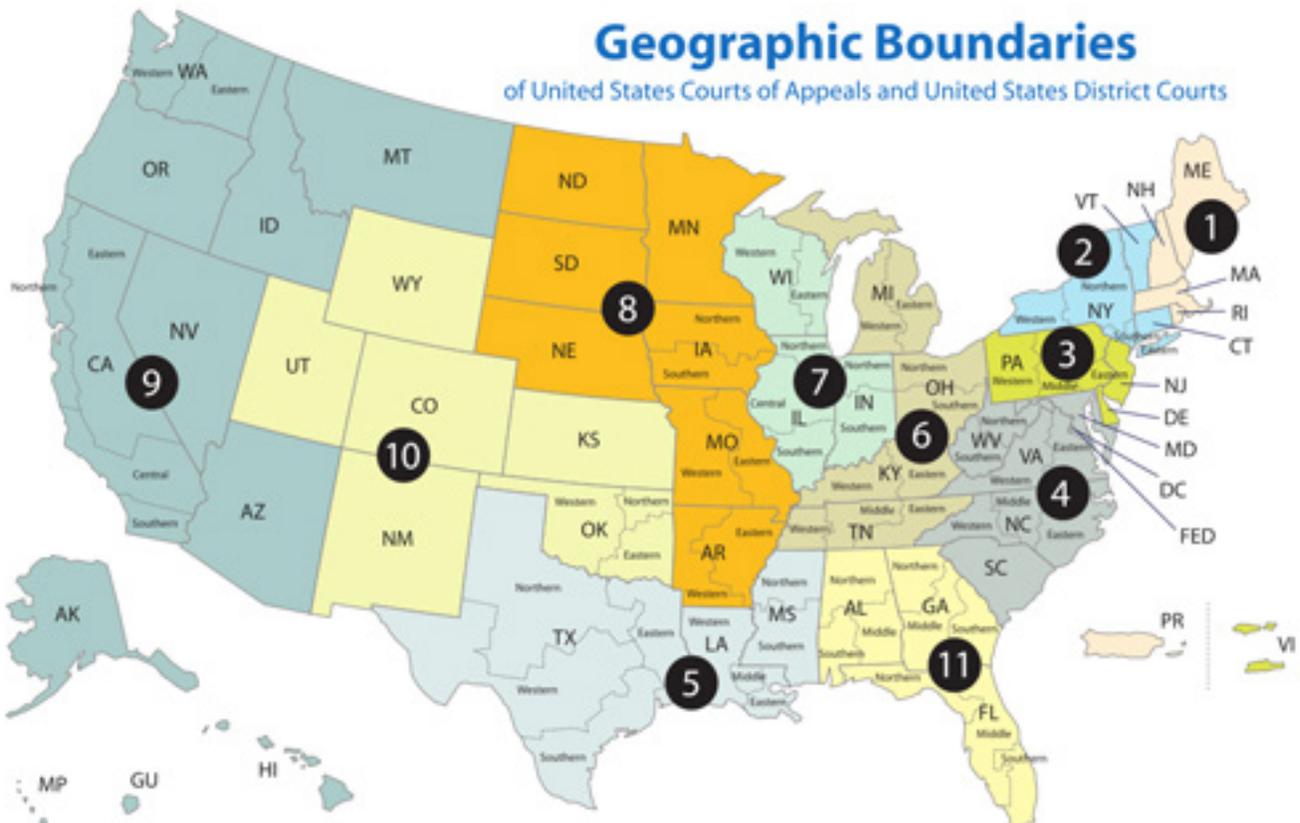


Chart Source: <http://www.uscourts.gov/uscourts/images/CircuitMap.pdf>

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## *Resolve the Issues*

The fourth step in the tax research process entails the resolution of your client's tax issues after identifying, analyzing, and interpreting all of the applicable authorities. It cannot be overstated that you should have provided, as needed, reasonable statutory, administrative, and judicial support to demonstrate that your position could be upheld if challenged by the Service upon examination and that you exercised due diligence and acted in good faith. Furthermore, at times, positions taken on tax returns may need to be disclosed on Form 8275 entitled "Disclosure Statement" or Form 8275-R entitled "Regulation Disclosure Statement" depending upon the complexity and controversial nature of the tax issue. Noting, by disclosing positions on your client's tax returns you may be able to avoid paid preparer penalties should your position be disallowed and avoid the application of the six year statutory period for assessment under I.R.C. § 6501(e).

From a risk management perspective, in order to mitigate or avoid income tax return paid preparer penalties pursuant to I.R.C. § 6694 (e.g., penalties that are assessed on both paid tax return preparers and tax advisers that are deemed paid tax return preparers due to their consulting on matters that constitute a substantial portion of their client's tax returns even if they were not engaged to prepare nor review the tax return), a "More-Likely-Than-Not" standard should be satisfied. The subsequent standards of the applicable levels of opinions should be scrupulously analyzed when assessing your tax return filing position:

- ▶ **"Will" Standard:** Generally, a 95% or greater probability of success if challenged by the IRS. A "Will" opinion generally represents the highest level of assurance that can be provided by an opinion;
- ▶ **"Should" Standard:** Generally, a 70% or greater probability of success if challenged by the IRS. A "Should" opinion provides a lower level of assurance than is provided by a "Will" opinion, but a higher level of assurance than is provided by a "More-Likely-Than-Not" opinion;
- ▶ **"More-Likely- Than- Not" Standard:** A greater than 50% probability of success if challenged by the IRS. The "More-Likely-Than-Not" standard is the highest level of accuracy required for purposes of avoiding the accuracy-related penalties under I.R.C. 6662A;
- ▶ **"Substantial Authority" Standard:** Typically, greater than a "Realistic Possibility of Success" standard and lower than "More-Likely-Than-Not" standard (i.e., 40% probability of success);
- ▶ **"Realistic Possibility of Success" Standard:** Approximately a one-in-three or greater possibility of success if challenged by the Service;

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- ▶ **“Reasonable Basis” Standard:** Significantly higher than the “Not Frivolous” standard (i.e., that is, not deliberately improper) and lower than the “Realistic Possibility of Success” standard. The position must be reasonable based on at least one tax authority that can be cited as valid legal authority;
  - ▶ **“Non-Frivolous” Standard:** Approximately a 10% chance of being upheld upon examination by the Service and accordingly under no circumstance should a tax professional ever render services with this level of comfort; and
  - ▶ **“Frivolous” Standard:** Approximately a percentage less than a 10% chance of being upheld upon examination by the Service and accordingly under no circumstances should a tax professional ever render services with this level of comfort.

It should be duly noted that each of the aforementioned standards above has a relevant meaning to both the taxpayers and tax professionals when evaluating a tax position and the related disclosure requirements. Noting, the percentages listed for “More-Likely-Than-Not” and “Realistic Possibility of Success” are specifically provided for and discussed in the treasury regulations. In contrast, the percentages for “Substantial Authority”, “Reasonable Basis”, “Non-Frivolous”, “Frivolous” have been developed based upon their relative importance in the hierarchy of standards of opinion as principally provided for in congressional committee reports. Moreover, while not mathematically calculable, the percentages are still practical in demonstrating the relative strength of one level as opposed to another level.

### ***Communicate with Your Client***

The fifth and final step in the tax research process entails communicating the conclusion to your client. Your client, of course, must ultimately make the final decision concerning what course of action to take, even though the client’s decision is guided by and often dependent upon the conclusions reached by you, the tax professional. It is strongly recommended that this tax advice be rendered to your client in a written format, as opposed to verbal communication, and preferably in a formal tax advice memorandum format (e.g., Facts & Circumstances Section; Issue(s) Section; Analysis Section; and Conclusion Section) meticulously discussing the applicable statutory, administrative, and judicial authority to appropriately document your due diligence in assessing the tax issues(s) and resolving them satisfactorily to reach a strong tax return filing position (e.g., “More-Likely-Than-Not”, “Should”, “or “Will” filing positions). Finally, caveat language in the form of a disclaimer should be documented within the tax advice memorandum for any areas of the tax law that were not within the scope and application of your tax research services (e.g., the scope and application of this tax advice memorandum analyses the

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federal-level tax consequences only and does not provide any advice or analysis in connection to any multi-state tax consequences nor any international tax consequences).

## Conclusion

By following the preceding all-inclusive steps in the tax research process you should be able to render your research services to your entire client base in a more efficient, effective, and productive manner while adequately weighing risk management concerns in connection to tax return filing positions. As a final reminder, the guidance contained in this article should be applied with due professional care including seeking further professional advice from a subject matter expert should it be deemed warranted based upon both the complexity and contentious nature (e.g., taking a tax position contrary to a Treasury Regulation on Form 8275-R, etc.) of the tax matter under review. (Originally published August 2013)

## About the Author

Peter J. Scalise serves as the Federal Tax Credits & Incentives Practice Leader for Prager Metis CPAs, LLC a member of The Prager Metis International Group. Peter is a highly distinguished BIG 4 Alumni Tax Practice Leader and has approximately twenty years of progressive public accounting experience developing, managing and leading multi-million dollar tax advisory practices on both a regional and national level.

Peter is a highly acclaimed thought leader in the fields of accounting and taxation with deep subject matter expertise in connection to designing, implementing and defending sustainable methodologies for specialty tax incentives including, but not limited to, research tax incentives; orphan drug credits; therapeutic discovery credits; accounting methods and periods; energy tax incentives in connection to green building envelope efficiency and benchmarking, solar energy, bio energies, fuel cells, wind turbines, micro turbines, and geothermal systems; and comprehensive fixed asset analysis incorporating principles of construction tax planning, cost segregation analysis and the final treasury regulations governing tangible property.

Peter is a renowned keynote speaker and an extensively published author on specialty tax incentives, tax controversy matters, and legislative updates from Capitol Hill for NAREIT, AGRION, USGBC, AICPA, ASTP, NATP, ABA, AIA, and TEI. Peter serves as a member of the Tax Faculty for CPAacademy, iShade and TaxConnections University (“TCU”). Peter serves on both the Board of Directors and Board of Editors for The American Society of Tax Professionals (“ASTP”) and is the Founding President and Chairman of The Northeastern Region Tax Roundtable.

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