INTRODUCTION TO TAX SCHOOL

INTERNAL REVENUE CODE STRUCTURE

The following structure applies throughout the Internal Revenue Code. You **must** understand the Code’s structure if you are to understand its numerous cross-references. Many rules, definitions, and exceptions apply **only** to part of the Code. You **must** recognize these.

**Example:** Section 61 defines gross income “for purposes of this **subtitle**.” That refers to **Subtitle A** of Title 26 of the United States Code. The definition provided applies only for purposes of **Subtitle A**, which deals with income tax; it has nothing to do with **Subtitle B** (estate and gift tax) or **Subtitle C** (employment taxes).

**Example:** Section 170(e)(1) provides: “For purposes of applying this **paragraph** . . . property which is property used in the trade or business . . . shall be treated as a capital asset.”

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treatment of “property used in the trade or business” applies only for purposes of Paragraph (1) of Subsection (e): it has nothing to say about the treatment of such property in other Paragraphs of Subsection (e), let alone any other Subsection of Section 170.\textsuperscript{2} But, see footnote two at the bottom of the page if you really want to feel frustrated.

**Example:** Perhaps the most concise – and also the most obtuse – language in the Code appears in the flush language to Section 509(a):

“For purposes of paragraph (3), an organization described in paragraph (2) shall be deemed to include an organization described in section 501(c)(4), (5) or (6) which would be described in paragraph (2) if it were an organization described in section 501(c)(3).”

Back in 1980, President Reagan, while first running for office, frequently quoted this passage. He used it to illustrate the grotesque complexity of the Code. Alas, the passage remains. Since that time, the Code’s six subtitles have morphed into eleven and the number of pages has approximately doubled.

Subtitles, chapters, and section numbers are used only once. For example, Subtitle A starts with Chapter 1 while Subtitle K starts with Chapter 100; however, each Chapter with Subchapters starts with “Subchapter A.”

Title 26 currently divides into **eleven** Subtitles:

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<th>Subtitle</th>
<th>Description</th>
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<tr>
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<td>2. <strong>Subtitle B: Estate and Gift Taxes</strong></td>
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Naturally, a basic J.D. level Income Tax course focuses mainly on Subtitle A. But, **Subtitle A** also includes the rules for courses such Corporate Tax,

\textsuperscript{2} Somewhat frustratingly, Section 170(b)(1)(C)(iv) provides: “For purposes of the preceding sentence, any property which is property used in the trade or business . . . shall be treated as a capital asset.” The prior sentence applies “for purposes of this paragraph.” As a result, the special definition affects all of paragraph (1), including subparagraph (D). Note, this particular restrictive treatment appears in Clause (iv) of Subparagraph (C) of Paragraph (1) of Subsection (b) of Section 170.
Reorganizations, Partnership Tax, Income Tax of Estates and Trusts, International Tax, Taxation of Insurance Companies, and Taxation of Financial Instruments. The course in Estate & Gift Tax (also called Gratuitous Transfers) mostly focuses on Subtitle B. Not surprisingly, a course in Tax Procedure focuses mostly on Subtitle F.

In contrast, a complete study of Deferred Compensation requires significant knowledge of multiple subtitles. The main rules for both qualified and non-qualified plans appear in Subtitle A. Qualified plans, however, are subject to a variety of excise taxes which appear in Subtitle D. Also, employment taxes, which support the social security system, appear in Subtitle C; however, the self-employment tax – which supports the social security system for independent contractors – appears in Subtitle A. Similarly, a course in Tax Exempt Organizations requires substantial study in Subtitles A, C, and F. Thus, for some courses, you must jump from subtitle to subtitle. This is one – among many – reasons tax law can be difficult to grasp: although related topics generally appear close to each other, sometimes they are thousands of pages apart!

Prior to 1939, the Code - if we could call it that – was a disorganized mess: both substantive and procedural rules appeared in various places with less than optimal reason. The primary purpose of the 1939 Act was to provide structure; indeed, legislative history clarifies that no substantive changes were hidden in the extensive reorganization. As a result, the act included the predecessor of Section 7806:

a) Cross references

The cross references in this title to other portions of the title, or other provisions of law, where the word "see" is used, are made only for convenience, and shall be given no legal effect.

(b) Arrangement and classification

No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion of this title, nor shall any table of contents, table of cross references, or similar outline, analysis, or descriptive matter relating to the contents of this title be given any legal effect. The preceding sentence also applies to the side notes and ancillary tables contained in the various prints of this Act before its enactment into law.

Hence, despite the extensive reorganization resulting from the 1939 Act, we must ignore it. Similarly we must ignore the titles to various code sections. Typically, these prohibitions are unimportant; however, sometimes, they become significant.

For example, the title to section 1341 refers to property “held” under a claim of right. From that, one might reasonably conclude the section applies only if the taxpayer initially receives something – what else could “held” mean? However, the language of the section – as opposed to the title of the section –
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does not include the word held. As a result, the section applies both to cash method taxpayers (who would have received the item) as well as to accrual method taxpayers (who may not yet have received the item, but instead who might merely have earned the right to receive the item). Bottom line: the title to the section and the section itself are inconsistent.

Similarly, prior to 1954, the predecessor to section 1312 appeared in the Procedure Subtitle, rather than in a taxing subtitle. It, however, included a provision restricting its application to income tax matters. As part of the 1954 reorganization, Congress moved the section to Subtitle A, which deals with income tax. At the same time, it repealed the words limiting the section to income tax. But, legislative history explains the reasoning: procedural rules of general application were moved to Subtitle F; however, procedural rules which applied merely to a single Subtitle were moved to the particular taxing Subtitle. Clearly, the drafters felt the language limiting section 1312 to income taxes was superfluous because the section was being moved to Subtitle A, which deals only with income tax. Courts, however, have not agreed. The Fourth Circuit has held that section 1312 applies broadly to all Subtitles, despite its location. The Seventh Circuit, however, has limited the section to the Subtitle in which it appears.

Which of those two Courts is correct is unimportant for this lesson. You must understand, however, that Code organization exists for sound reasons. Whether those reasons have ultimate legal significance – i.e., does section 7806 mean what it says – is not a settled matter. Plus, do not rely on titles: they sometimes contradict the statute!

Let’s end this lesson with some humor. Examine section 168(i)(2)(B), which deals with depreciation:

“(B) Computer or peripheral equipment defined
For purposes of this paragraph--
(i) In general
The term "computer or peripheral equipment" means--
(I) any computer, and
(II) any related peripheral equipment.”

Note the structure. Section 168. Subsection (i). Paragraph (2). Subparagraph (B). Clause (i). Subclause (I). This is located in Part IV of Subchapter B of Chapter 1 of Subtitle A of Title 26 of the United States Code.

Now, read the substance: the definition of a “computer” is a “computer.” Fair enough . . . except, that is only the definition “in general,” whatever that means. And, notice further: this definition applies only for purposes of Paragraph (2) of Subsection (i) of Section 168. Unless the definition is specifically adopted
elsewhere – as it happens to be in Section 280F(c)(4)(A)(iv) – then the word “computer” remains undefined! Also, ponder this: Congress paid someone to draft that language.

What You Should Learn From This Lesson:

1. You must pay close attention to the phrase “for purposes of” whenever you read it. **Highlight it.** Carefully examine what the related restrictive language affects and what it does not affect.

2. Understand the Subtitles, Chapters, Parts, and Subparts of the Code. Congress created them ostensibly to help you.

3. Do not forget about Section 7806.

4. Sometimes, tax law is funny.

5. If you really want to see something funny, examine the way some publishers print the Code and the Treasury Regulations. Generally, they helpfully indent the various levels of Code structure; however, many publishers print all similar structural levels for the Treasury Regulations with a straight left justified margin. That can be particularly difficult to read (especially in 8-point type).