Caregiver vs. W-2 Reporting • Simple Substantial Economic Effect Regulatory Compliance

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U.S. Tax Implications of
FOREIGN INCORPORATIONS

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Let's Educate America!

Terry Durkin, EA

NAEA's Educating America program is key to our future. This three-phase program brings the EA profession to US colleges and exposes the EA career to the next generation of enrolled agents. The first phase of the program is designed to introduce the EA Exam Prep (formally called SEE Prep) as a non-credit course to vocational tracks at community colleges. NAEA's Educating America Task Force and many state affiliates are well on their way with this phase. The college environment is a relatively untapped market for us to increase the recognition of enrolled agents, NAEA's number one strategic goal.

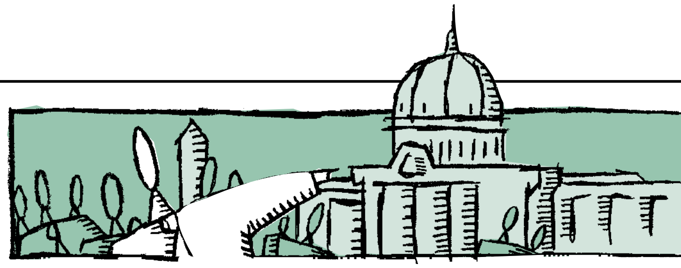
Additionally, the Educating America program has the potential to grow our NAEA membership. With over thirteen million students enrolled at community colleges nationwide, we could add 13,000 to our membership if NAEA touches just .1% of those students—which more than doubles our current membership of just over 11,000. The Educating America program also provides non-dues revenue opportunities for affiliates when the EA Exam Prep course is offered at local colleges. NAEA members also benefit personally from this program. By participating at college job fairs and in mentor/internship programs, members gain access to a new source of staffing for their firms. In May, the Board of Directors approved a two-year, complementary membership for academic associates. Let's capitalize on this opportunity and show college students how great it is to be an enrolled agent.

In other education news, we had an extremely successful National Conference at which we celebrated NTPI's 30th anniversary. It was a 'pearl' of an event. I want to give a big thanks to all the dedicated volunteers and instructors who have made this the premier event in tax representation education.

Another NAEA education exclusive, the Schuldiner/Smollan Leadership Academy (SSLA), will be held right after the November board meeting in Orlando, Florida. Over the last four years, the SSLA has provided leadership skills training for NAEA members across the country. It is wonderful to see how SSLA alumni are making a difference and strengthening their chapters, affiliates, and NAEA as a whole.

In other important news, the Board is continuing to follow NAEA's succession plan in the search for our permanent EVP. Sterling Martin Associates was selected in July as our search firm. They are actively engaged to find quality candidates for the search committee to interview. We are another step closer to our goal of finding the right EVP for NAEA.

Let's keep the momentum going and make today a great day to be an EA! EA



CAPITOL CORNER

The Only Difference Between Death and Taxes…

By Robert Kerr

I write this during the dog days of summer while pondering my recent travels to our state affiliates in Massachusetts, Arizona, and California. I would like to thank my gracious hosts in Waltham, Flagstaff, and San Diego and congratulate new leadership in all three states. I continue to be humbled by your enthusiasm and inspired by your desire to learn more and to be more.

I was fortunate to lead a course or two in MA and AZ at which I discussed tax policy and tax reform. At CA's annual meeting, I was able to discuss GR issues (and to stump for NAEA PAC, of course!) at length. The common thread in all three locations (and, to be fair, over a much longer time frame) was tax reform, a topic I find endlessly fascinating.

While a lot of ink has been spilled by a lot of people—politicians, economists, public policy experts, the financial press for starters—a fundamental truth (or an inconvenient truth as Al Gore once famously put it) that invariably gets the short shrift is this: fundamental tax reform is difficult.

The troubles are myriad. I am reminded of the parable of the blind men who are tasked with describing an elephant. The descriptions vary widely depending on which part of the elephant they touched. In taxes, different players come to the table with widely different perspectives on what tax reform is and what tax reform should be, and on the larger, more important question: What is good tax policy?

Economists—and don't get me wrong, some of my closest friends are economists—have an interesting, if completely divorced from political reality, view on taxes. They generally concur (well, to the extent economists agree on anything) that the role of a tax system is to fund the government with the least deadweight loss. Deadweight loss (yes, I saw you running for your Google!) is, roughly, a loss to society as a whole because of tax-induced disincentives to work and/or because the time spent on tax-avoiding behavior is unproductive. Further, economists generally believe that a tax system should be simple (compliance should be easy and cheating should be difficult), equitable (certain people or activities should neither be rewarded nor punished), efficient (low deadweight cost), and predictable (those who are taxed—more on that in a minute—should know what to expect today and tomorrow).

When I read that list I think "man, that's absolutely, spot-on correct!' I'm particularly fond of the principle of predictability and, when advocating for enrolled agents, continually suggest to legislators that taxpayers deserve the right to plan. A former colleague of mine who is now a mover and shaker in economics and federal policy recently suggested that our chronic extenders problem has created a permanent state of temporary tax policy, which is as well stated as it is undesirable.

About the Author

Robert Kerr has served as NAEA's senior director, Government Relations since 2004. Prior to joining NAEA, Kerr worked on the Senate Finance Committee Oversight and Investigation staff, where he assisted the committee chairman in providing oversight to, among others, IRS, U.S. Postal Service Office of Inspector General, and General Services Administration. He also spent a dozen years in a variety of positions at IRS and is well-versed in a variety of tax administration issues. Kerr holds an MBA from Case Western Reserve University and a BA from Mount Union College.

In taxes, different players come to the table with widely different perspectives on what tax reform is and what tax reform should be, and on the larger, more important question: What is good tax policy?

Before we leave behind the economists, let's talk about corporate taxes for just a minute. First, the current tax code severely distorts business decisions (depreciation and expensing rules are one example, debt financing vs. equity financing is another) and clearly fails on any horizontal equity measure. And finally—thanks for bearing with me here—most economists agree on the following principle: corporations don't pay taxes, people pay taxes. Corporations pay taxes with money they receive from individuals either from higher prices or lower returns on stock investments.

Is this why tax reform is hard? Well, no, not exactly. The economists are useful because they frame the tax reform discussion by asking the baseline questions: What's the point of taxes and, given that taxes themselves are undesirable, what does good tax policy look like?

The real reason that tax policy is so terribly difficult isn't because economists aren't in charge, so to be sure economists would not agree on the ideal U.S. tax policy (economists fall on a conservative-liberal spectrum too). The real reason tax policy is so difficult is two part: a) politicians are in charge; and b) the power of entrenched interests.

Taxes are political, purely in the political realm, and have been forever. King Louis XIV's finance minister, Jean Baptiste Colbert, famously suggested, "The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the smallest amount of hissing." And that was the middle of the seventeenth century!

The last time Washington managed to reform federal income taxes was in 1986—when Mr. Mister and Robert Palmer (you remember the "Addicted to Love" video, don't you?) topped the pop charts. In the intervening years, a lot has changed (other than hair styles and music) and while most agree the current tax code is an abomination, there is little consensus on how to fix it.

Those of you following the ongoing dialogue (if that's what the name-calling from both sides of the aisle can be called) from home probably already understand the tough choices that tax reform necessitates. The current tax code has evolved over time to include lots and lots of so-called "loopholes." At the same time, most reform discussions center on the mantra that was successful in the 1980s: Broaden the base and lower the rates.

But let's look at what broadening the base means. On the personal side it would include, among other things, throwing over the deductibility of state and local taxes, eliminating the tax free status of employer-provided health insurance, ditching the deductibility of mortgage interest, eliminating the pre-tax treatment of retirement contributions, and ending the step-up in basis for estates. The corporate side of the equation is just as scandalous.

If everyone paid less in taxes because the new rates were so much lower than the old rates, we might have a shot at reform. The trouble is that tax reform, in my humble opinion, is a zero-sum game. Some individuals and businesses would emerge better off, but some would emerge worse off and some of those would emerge much worse off. Those emerging worse off are going to lobby up to the extent they are able and fight tooth and nail.

And the above thumbnail ignores another political problem: The two political parties cannot even agree on the baseline rules for tax reform. Liberals largely believe that the tax system should raise even more money than it raises today (and that it should redistribute more income from high earners to low earners) while conservatives largely believe the tax system should raise no more than it already does (and probably quite a bit less).

*****

I could go on and on—and, to warn those members whose states I'll be visiting later this year, I do in my Tax Reform 101 course. Not to put too fine a point on it, but I am not at all optimistic about a significant tax code overhaul. Not that such a thing isn't desirable (and in fact necessary), because it is.

In fact, we'll be lucky if we are reading this article after Congress has addressed a small, self-induced, and fairly manageable problem: extenders. If we're lucky, they will have extended for 2015 and 2016 before leaving for August recess. If not, it won't be for lack of hearing from the enrolled agent lobbyists that the current state of affairs is untenable.

As for me, I'll be taking advantage of recess by heading to the beach with my copy of *Showdown at Gucci Gulch*, which is the definitive history of the machinations behind the Tax Reform Act of 1986.

As the great American humorist Will Rogers famously quipped, "The only difference between death and taxes is that death doesn't get worse every time Congress meets."

Amen. EA

U.S. Tax Implications of FOREIGN INCORPORATIONS

Anthony Malik, EA

Introduction

Growing businesses often explore and gradually expand into new markets. This expansion (depending on a particular business's nature and ambitions) may be local, regional, or international in scope. Internationally expanding business, depending on cross-border activity levels, may delve into foreign markets in one of several ways. These may include:

- Domestically conducting sales with persons abroad
- Licensing products to a foreign business
- Entering a joint venture with a foreign partner
- Starting a foreign branch
- Establishing a foreign subsidiary

These market entry modes have unique advantages and disadvantages that must be considered in light of a U.S. business' entity type, functions, and objectives. In practice (driven by myriad tax and nontax considerations) many businesses eventually establish foreign subsidiaries once they gain a foothold in a foreign market. Remember: a foreign subsidiary is a foreign corporation chartered abroad to locally conduct foreign operations.

This article is an introduction to the U.S. tax implications of transfers effectuating outbound incorporations. Namely, this means establishing a foreign subsidiary. While this article assumes the U.S. business to be a regular corporation (C-Corporation), it should be noted that the tax laws governing foreign incorporations are indiscriminately applied to all taxpayers—regardless of type.

Tax Law's Security Checkpoint

Assets transferred across the U.S. border to form a foreign corporation acquire a fleeting, character deserving scrutiny. The mechanism of this scrutiny, anatomized within IRC Sec. 367, vitiate the gain nonrecognition rules of IRC Sec. 351. Specifically, while IRC Sec. 351 covers the incorporation of a foreign business, IRC Sec. 367 limits its scope. As a matter of policy, the anti-nonrecognition rules of IRC Sec. 367 are designed to deter taxpayers from shifting the potential income of U.S. impetus outside the U.S. taxing jurisdiction. As a matter of practice, the law requires a two-tiered assessment of outbound transfers. This is to say that practitioners first must determine the applicability of IRC Sec. 351 followed by determining the applicability of IRC Sec. 367. To travel across the U.S. border tax-free, the transfer must meet the tests of the former and qualify for one of the uncontested exceptions to the general rule of the latter.

The general rule of IRC Sec. 367 denies gain nonrecognition any time an asset leaves the U.S. taxing jurisdiction. Interestingly, the language of the law denies this gain nonrecognition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deductively. This suggests that rather than directly addressing the transfer, the statute denies the transferee corporate status for purposes of the transaction. This results in the annulment of IRC Sec. 351 and thereby annuls gain nonrecognition. IRC Sec. 367, from the onset, quickly unfolds into an intricate legal constellation by cross-referencing numerous code sections, superimposing exceptions upon exceptions, and so on. For the purpose of our discussion, we will limit the subject to the major exception to the general rule: The foreign trade or business exception, along with the most common exceptions to this exception. Delving any deeper would require a science-grade telescope.

Trade or Business Exception

It is useful to briefly consider the rationale of the general rule before meditating on any appurtenant exceptions. The general rule denying gain nonrecognition is, in fact, a very viable way of combating tax avoidance. Consider that in the absence of the general rule, astute taxpayers could transfer appreciated assets across the U.S. border in a tax-free IRC Sec. 351 transaction and arrange for a sale via the foreign subsidiary. The gain from this hypothetical sale would avoid U.S. taxation—even though the built-in gain (the appreciation in the asset's value), would be U.S. source income. Keeping with this concept, one can see that IRC Sec. 367 acts as a backstop to this potential loophole. However, the law then has to extend exceptions to transactions lacking a tax avoidance motive. Thus, the primary exception is made for transactions with a bona fide business purpose.

The major exception to the general rule of IRC Sec. 367 preserves the transferee's corporate status whenever the transferred assets are legitimately meant for use in an active trade or business outside the U.S. In turn, this extends gain nonrecognition to the transaction, rendering it tax-free. The regulations impose a stringent, four-part test that must be completed in order to qualify for the trade or business exception (Treas. Reg. Sec. 1.367(a)-2T).

Very broadly, the four provisos that must be satisfied are :

1. A legitimate trade or business must exist. The law essentially states that an enterprise meets the legal definition of a trade or business when it sufficiently and substantially constitutes the necessary business processes and procedures essential to independently conduct profit-oriented activities. In other words, the trade or business must be a reasonably complete and self-sustained operation—not simply a collection of functions that are ancillary to the conduct of a trade or business.
2. The transferee must actively engage in the conduct of the trade or business. This proviso is satisfied when the employees and managers of the transferee conduct substantial operational and managerial activities in pursuit of the business. The law then articulates the role of independent contractors and "leased" personnel of related parties in this regard.
3. The transferee's active engagement in the trade or business must be outside the United States. Needless to say, the trade or business *itself* must be located outside the U.S. Otherwise, U.S. taxpayers could transfer appreciated assets abroad tax-free and subsequently continue operating a purely U.S. business through a foreign incorporated entity. Additionally, to prevent U.S. taxpayers from shifting gains outside the U.S. by executing circular transfers, this stipulation concomitantly requires the assets to remain outside the U.S. once transferred. Both requirements clearly subdue the income shifting potential of foreign incorporations.
4. The transferred property itself must be used (or held for use) in the trade or business. This statute is in line with the jurisprudentially developed business purpose concept. In order for the prescribed tax treatment to follow, this concept requires a sound business reason to motivate the transaction. Tax avoidance is not a sound business reason.

It is critical to note that the aforementioned outline is synoptic. The germane paragraphs of Treas. Reg. Sec. 1.367(a)-2T constantly articulate that each stipulation "must be determined under all the facts and circumstances." The law clearly prohibits a priori assumptions in this area and tax practitioners must perform their due diligence in each case.

It should be noted that IRC Sec. 367(a) only applies to gains. In other words, loss recognition is not allowed in any event (as stated in Treas. Reg. Sec. 1.367(a)-1T(b)(3)(ii)). As shown in the case of denying gain nonrecognition, it is useful to briefly consider the rationale for denying loss recognition on an outbound incorporating transfer. Consider that in the absence of loss nonrecognition, a U.S. taxpayer with a high income could selectively transfer only loss property in an outbound incorporation, thereby reducing its U.S. tax liability. Thus, Congress' principal objective in disallowing loss recognition is to prevent taxpayers from artificially reducing their U.S. tax liabilities by concluding potential loss stuffing transactions.

Exceptions to the Exception

Certain classes of assets embody key exceptions to the exception in the sense that the transfer of these assets triggers some sort of immediate gain (but not loss) recognition. This is irrespective of whether the active trade or business exception is satisfied or not. One important class of such assets includes "tainted assets" which are treated as having been sold by the transferor when transferred abroad. The resulting gain is capital or ordinary, depending on the asset's economic relation to the transferor. IRC Sec. 367 lists the following as tainted assets:

- Inventory
- Installment obligations and unrealized accounts receivable
- Foreign currency
- Intangibles
- Property leased by the transferor unless the transferee is the lessee

Note that each of these tainted assets present the transferor with opportunities to manipulate the international source of income rules. For example, anticipated U.S. source income from installment obligations, accounts receivables, or rental receipts from leasing personal properties would become reclassified as a foreign source merely by transferring ownership of the underlying assets to a foreign person. Similarly, transferring inventory to a foreign subsidiary enables a multinational enterprise to arrange the passage of title in a sale to take place outside the U.S. Since a sale is deemed to take place where title passes (Treas. Reg. Sec. 1.861-7(c)), U.S. taxpayers could avoid U.S. taxation by siphoning income to a foreign tax jurisdiction through a foreign corporation. Realizing the potential for abuse afforded by tainted assets, Congress imposes the deemed sale rule onto the transferor. It should be mentioned that of all the aforementioned tainted assets, intangibles are separately taxed pursuant to special rules (IRC Sec. 367(d)).

Besides gain recognition on tainted assets, the law also requires that the recapture of certain previously claimed U.S. tax benefits to the extent gain is realized. While depreciable assets under IRC Sec. 1245 and 1250 yield the most common recapture potential, it should be mentioned that there are also certain industry-specific (mining, farming, oil & gas, etc.) benefits that are required to be recaptured. Note that unlike tainted assets, assets yielding previously claimed tax benefits are not deemed sold to the transferee in an IRC Sec. 367 transaction. Rather, the transferor is required to report the amounts of previously claimed U.S. tax benefits as ordinary income to the extent of realized gains—not recognized gains. This legal requirement of recapture therefore precludes taxpayers from enjoying a potential double tax benefit, such as transferring a previously depreciated U.S. situs asset in a foreign incorporation and consequently selling the then foreign situs asset free of U.S. depreciation recapture. Of course, there is no such recapture of previously claimed U.S. tax benefits in the case of transferred properties carrying realized losses. This is logical since IRC Sec. 367 does not apply to losses and this treatment is also consistent with domestic tax provisions addressing recapture.

Conclusion

The incorporation of a foreign business by a U.S. taxpayer implicates a plethora of U.S. tax laws designed to prevent tax avoidance. Ultimately the taxation—or tax deferral—of outbound incorporating transfers depends on underlying economic factors such as the nature, character, destination and income potential of the transferred assets. When serving a globally expanding business client, tax practitioners must diligently obtain all the relevant facts and circumstances when turning to the law for guidance. **EA**

About the Author:

Anthony "Tony" Malik, EA, is the principal consultant and owner of Point Square Consulting in Atlanta, Georgia. He specializes in representation and international taxation (individuals and businesses). Tony practices a wide range of multijurisdictional tax issues spanning across compliance, planning, and litigation. Tony enjoys answering tax questions from the EA community and can be reached at tony@pointsquaretax.com.

To learn more about this topic, visit the NAEA Forums.

Caregiver CALAMITIES

CAREGIVER VS. W-2 REPORTING

BEN A. TALLMAN, EA, USTCP

I believe one of the most significant topics for tax professionals in the next ten years will be the proper reporting of caregiver and domestic employee income. Why? As baby boomers age, they will begin requiring caregivers to assist them with day-to-day living. It is imperative that we assist these elderly taxpayers with properly reporting caregiver income. Some of our friends in the legal community believe that reporting this income on a 1099 is good enough. I am here to tell you that regulations tell us otherwise.

The law says all domestic employees are to be paid on W-2s. Are caregivers considered domestic employees? Not knowing could cost your client thousands of dollars in denied medical deductions and thousands more in unpaid payroll taxes. If that doesn't grab your attention, the Department of Labor, Social Security, and unemployment taxes could charge much more for penalties and missing over-time pay. Mishandling this item could create a disaster for clients and be a legal nightmare for a tax preparer.

A domestic employee is someone whom you employ to work in or around your home. Positions may include gardeners, landscapers, housekeepers, maids, caregivers, or full-time handymen. I will limit this discussion to caregivers.

How should they be paid? The IRS says it depends on their employment status and the authority you have over them. If you pay a company that already treats them as employees, then the answer should be obvious and you are off the hook, so to speak. However, if these are individuals (including sole-member LLCs) you must look at the behavioral, financial, and personal control you hold over the worker. Do you dictate when the individual should come to work? Do you assign duties? Do you provide the items the worker needs to perform his or her job? Is there potential for the person to lose money by working for you? Does he or she perform the same job for anyone else? If the first three answers are 'yes' and the last two are 'no,' then you most likely have a domestic employee.

Caregiver CALAMITIES

Domestic employee earnings are to be reported on a W-2—and yes, you can still use Schedule H at the end of the year to pay his or her FICA and withholding tax. Most states allow you to pay unemployment tax on domestic employees once a year in January, following the tax year. Of course, you must register in advance for an ID Number.

What about 1099 Forms? Colleagues and attorneys may advise us that paying a caregiver on a 1099 is okay. As I said earlier, IRS disagrees. The law is specific when it comes to individual caregivers working in your home (or a parent's home). Unless the caregiver is a certified specialist—like a nurse practitioner who works for several families—the 1099 argument has no merit. However, the Department of Labor insists these individuals are employees. DOL may also be interested in the number of hours worked per day or per week to determine if over-time pay is warranted. The average pay for a live-in caregiver is just over $75,000 a year[1]. Do you think that over-time pay was considered in this equation? I wouldn't bet on it.

So how do we handle over-time? In my humble opinion, your taxpayer will require an employment contract that states weekly, monthly, or annual salary paid to provide in-home care. In most cases, you would also provide a place to sleep, meals, occasional days off, access to a vehicle, and possibly even a cell phone. My research shows these are non-taxable fringe benefits similar to someone who works on an oil rig. The DOL will probably insist they receive a salary equivalent to minimum wage times 24 hours/day times 365 days/year. The only factor taken out of the equation is over-time.

We have talked about the IRS and the DOL, but we haven't considered long-term caregivers that were paid on a 1099 and then apply for Social Security. When they visit the SSA Office to apply for benefits and it is determined they have no Social Security paid in, who do you think they come looking for to pay the back FICA taxes? It will be the families that hired them for extended periods and never reported their wages on a W-2. When this happens, do you think their tax advisor could be sued for malpractice or willful negligence? How good is your E&O Insurance? Do you see where I am going with this?

I have heard stories where caregivers refuse to provide their Social Security number for tax reporting. Are there reasons they would not want to report this income? This income could take away Section 8 housing, food stamps, temporary disability payments, and other programs based on low-income qualifications. The reasons could be endless, but if you satisfy the caregiver, you sabotage the taxpayer. Don't forget there are three agencies to face: IRS, SSA, & DOL. Since this is considered fraud, there is not statute of limitation.

Assuming we are compliant with our caregiver, are there any tax benefits that can be derived from such a large outlay? Let's take a look at the potential tax deduction for hiring a caregiver. First, determine whether or not the person being cared for can no longer perform two of the six activities of daily living. These six activities are listed below. An inability to perform at least two of the activities (along with a doctor's statement)[2] make the caregiver's expenses deductible:

- Eating or the ability to feed oneself, though not necessarily prepare food
- Personal hygiene such as grooming and oral care
- Transferring oneself from a seated to a standing position, as well as getting in and out of bed
- Ability to bathe or shower oneself
- Dressing and the ability to make appropriate clothing choices
- Maintaining continence or the ability to properly use a restroom

With the doctor's diagnosis, stand-by care can be prescribed. This will allow an unlicensed caregiver to help out. As long as the caregiver is paid as an employee, the expense can be deducted under medical expenses on Schedule A. Since this usually involves tens of thousands of dollars per year, the 7.5 percent or 10 percent medical deductible will not be a problem. The critical keys to this working

Unless the caregiver is a certified specialist ... the 1099 agreement has no merit.

are the doctor's diagnosis and payment to the caregiver as an employee on a W-2 form.

Let's look beyond the medical deduction and examine any other tax benefits that may exist. What if the elderly taxpayer now finds himself in a position of negative taxable income? If they have money in a traditional IRA, they could do a ROTH conversion and move the projected funds needed to break even the next year. This is a nice way to pull out IRA funds tax-free. Some elderly taxpayers might have life insurance policies that have a conversion provision allowing the policy funds to be used for long-term care. This could be worth checking out if the taxpayer is running low on financial reserves. If an adult child is paying for his or her parent's caregiver, can they claim the parent as a dependent even if they do not live together? Yes. This is becoming very common if the child is paying over half of their parent's support. Several children can rotate the deduction under a Multiple Support Declaration.

To read more about this topic check out irs.gov or Google on 'domestic employees,' 'caregivers,' Schedule H (Instructions and Q&A), Form 8919 (Instructions and Q&A), and SS-8 (Instructions and Q&A). **EA**

About the Author

Ben Tallman, EA, USTCP, is an alumnus of the University of West Georgia and has a tax practice in Atlanta. Ben has served on the NAEA National Board as Chairman of the Education Foundation, is a prior member of the IRS Regional Liaison Committee, and a prior Educational Director for two GA Affiliate Organizations. He often appears on Tax Talk Today in discussions on the Affordable Care Act, and writes extensively for national tax publications and journals. Ben is an NTPI Fellow and recently celebrated 40 years in tax preparation.

To learn more about this topic, visit the NAEA Forums.

ENDNOTES

1. Based on $10/hour x 24 hours x 6 days a week x 52 weeks = $74,880
2. Statement must have been issued within the past twelve months

SIMPLE SUBSTANTIAL ECONOMIC EFFECT REGULATORY COMPLIANCE

BY DAVID RANDALL JENKINS, Ph.D.

Introduction

A common American funding dilemma involves an upstart entrepreneur's highly viable business venture. Typically, he or she lacks the essential cash equity and debt financing creditworthiness to fund operations. It is in this setting that IRC Sec. 704(b) special allocations may be used to affect venture expected risk-return combinations as a means to entice active capital business partner participation.

In a $350,000 venture funded by $250,000 debt and $100,000 unilateral capital business partner cash, it's possible for the equity contributing partner to receive first year specially allocated deductions sufficient to receive tax refunds approximating the equity contribution. However—and to the same extent—public policy discourages going concern productivity abandonment. Such is the power of partnership special allocations.

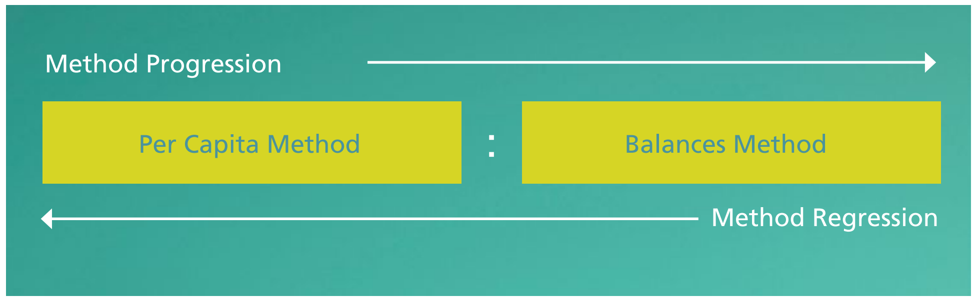
Along these lines, the IRS notes that "special allocations permit partners to assume different levels of risk and to set the timing of income in accordance with their preferences."[1] Moreover, merging operations and capital interests enable venture fundings that might not otherwise come to pass. "Bringing together creditworthy partners with partners who have a terrific business idea underscores America's entrepreneurial spirit," says Tim Collins, a First Vice President of Government Guaranteed Lending at The Bancorp, a nationwide preferred SBA lender.[2] "Improving both partners' startup venture expected returns by supporting creditworthy partner participation with more immediate tax benefits is a strategy the Small Business Administration has embraced in past transactions I've submitted," Collins encourages.

The IRS also recognizes, "The rules governing partnership allocations (IRC section 704(b) and its accompanying regulations) have been criticized as being some of the most difficult and complex." Commentators generally share this view.[3] This paper contributes to the partnership special allocations conversation by distilling such perceived complexities to simple substantial economic effect regulatory compliance.

Substantial Economic Effect Overview

Traditionally, sustaining substantial economic effect partnership special allocations involves a two-part test.[4] Under the first part, the allocation must have economic effect.[5] Under the second part, the economic effect must be substantial.[6] The *Vecchio* Tax Court states that if the special allocation either lacks economic effect or the economic effect is not substantial, the partners' distributive shares are determined, by default, according to their respective partnership interests.[7] The *Vecchio* teaching accordingly emphasizes the importance of partnership capital account accounting methods and method transitions.

FIGURE 1: (PER CAPITA: BALANCES) METHOD



The trinity of economic effect requirements include: capital account maintenance,[8] final liquidation according to capital account balances,[9] and final capital account deficit restoration.[10] The general substantiality definition requires a reasonable possibility that the allocation will affect substantially the dollar amounts to be received by the partners from the partnership, independent of tax consequences.[11]

Commentators generally agree that if the allocation goes against any of the three insubstantiality tests, economic effect is deemed insubstantial.[12] The insubstantiality test troika includes: the After-Tax Economics Consequences Test,[13] the Shifting Tax Consequences Test,[14] and the Transitory Allocations Test.[15] The insubstantiality tests make compliance complex because they uniformly impose tax consequence analyses at both the partnership and partner levels.

The lesson here is that simple substantial economic effect regulatory compliance occurs by and through:

a) (Per Capita: Balances: Ratio) capital account accounting method truncated transitivity because such truncated transitivity inherently—
   - meets economic effect equivalence regulatory requirements
   - fulfills the presumptive Per Capita method rebuttal factors
   - fulfills substantiality's general definition
   - moots the insubstantiality test troika

b) Substantiality's conclusive presumption.

Partnership Capital Account Accounting Methods

Economic effect and substantiality facial reviews miss the underpinning importance partnership capital account accounting method transitions hold for determining distributive shares by a partner's interest in the partnership. Treasury Regulation Sec.1.704-1(b)(3)(i) defines a partner's interest in the partnership. Most important, this provision establishes a presumptive capital account accounting method, to wit:

> All partners' interests in the partnership are presumed to be equal (determined on a per capita basis).[16]

Equal capital account allocations and distributions on a per capita basis defines the per capita capital account accounting method. The per capita method presumption is rebuttable by either the taxpayer or the IRS by establishing facts and circumstances that show that the partners' interests in the partnership are otherwise.[17]

The per capita method rebuttal factors include:

(a) the partners' relative contributions to the partnership
(b) the interests of the partners in economic profits and losses
(c) the interests of the partners in cash flow and other non-liquidating distributions
(d) the rights of the partners to distributions of capital upon liquidation.[18]

Agreeing to the rebuttal factors entitles several observations. First, distributions are bifurcated into going concern and liquidation factors while allocations of economic profits and losses remain as going concern and liquidation distinctions. The distinction is important for the reason going concern profits and loss allocations may occur under one method while liquidation profit and loss allocations may occur under a different method following transcending capital account adjustments.

Second, the per capita method rebuttal factors are coextensive with the Treasury Regulation Sec. 1.704-1(b)(2)(iv) capital account maintenance requirements, the first prong of economic effect's trinity. Accordingly, the per capita method rebuttal factor reconciliation usually and concomitantly fulfills economic effect's first prong.

(Per Capita: Balances: Ratio) Method Truncated Transitivity

Partnership agreement provisions control capital account accounting method transitions. The threshold per capita method presumes equal partner contributions and going concern and liquidation profit and loss allocations and distributions. When the partnership agreement countenances disparate partner contributions, going concern, liquidation profit, and loss allocations and distributions are computed on the basis of period beginning capital account balances. As a result, there is an effective (Per Capita: Balances) method progressive transition. The balances method uses intra-period, beginning balance based capital account ratios to allocate going concern and liquidation profits and losses and to make going concern and liquidation distributions.

Hypothetically, if the partnership agreement provided going concern distributions by the balances method but liquidating distributions by the per capita method, then a pre-liquidation capital account adjustment is required prior to liquidating distributions. The adjustment would result in all capital account balances being equal prior to liquidation. Such liquidation capital account adjustments cause a (Balances: Per Capita) method regressive transition. Since the partnership agreement provides provisions effecting both progressive and regressive method transitions it can be said there is capital account accounting method transitivity. See figure 1.

It is also not unusual for partnership agreements to include provisions which substantively effect a (Balances: Ratios) method transition. Here, we recognize two bases for progressively transitioning to the ratios method: reconciling disparate capital contributions and special allocations. That is, the ratios method allocates and distributes going concern items on the basis of assigned capital account ratios while insulating disparate capital contribution reconciliation and special allocations accounting.

The per capita method equally allocates and distributes all going concern and liquidation capital account items. The balances method allocates and distributes going concern capital account items on the basis of intra-period capital account ratios, while the ratios method allocates and distributes those same items on the basis of inter-period capital account ratios. The three capital account accounting methods are distinguished accordingly (see figure 2).

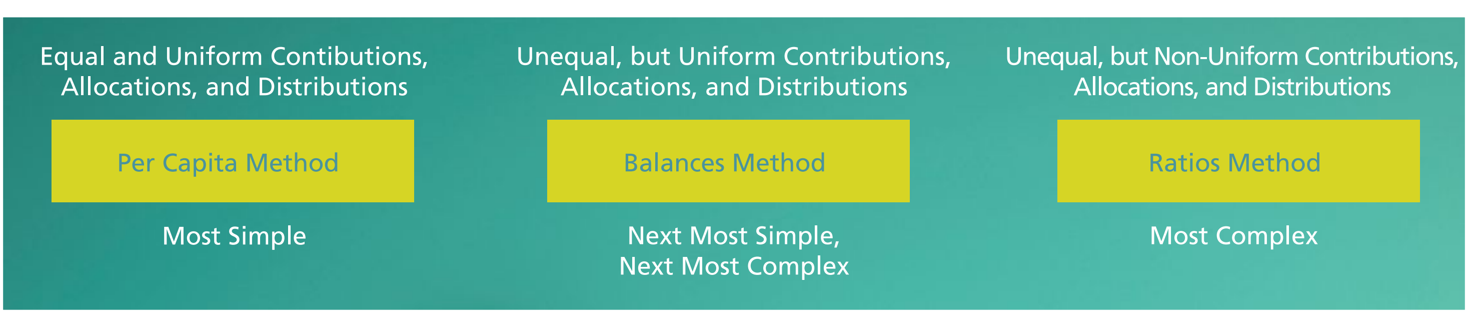
The second economic effect trinity prong requires liquidation by positive capital account balances after taking into account all pre-liquidation capital account adjustments.[19] As a result, (Ratios: Balances) method transition is a permissible pre-liquidation necessary condition. The partnership agreement must include pre-liquidation capital account adjustments.

The object of (Ratios: Balances) regressive transition pre-liquidation adjustments is to effect (Balances, Ratios) method indifference. Method indifference fulfills "as if" liquidation economic effect equivalence and rebuts the Per Capita method presumption.[20]

Note, however, while economic effect trinity's second prong requires liquidation by positive capital account balances, it does not require liquidation by equal positive capital account balances. As a result, a further regressive (Balances: Per Capita) method transition is unnecessary. This effect is illustrated in figure 3.

The first regressive (Ratios: Balances) method transition pre-liquidation adjustment, Ex-Ante Liquidation Capital Account Deficit Restoration, unconditionally requires partners restore their capital accounts to positive dollar balances in amounts that are the product of their capital account ratios and, say, $100. This adjustment may cause one or more partners to make further contributions to the partnership.[21] Following this adjustment, all partner capital accounts have positive dollar balances and the restoring partners' balances are in relation to their respective capital account ratios.

FIGURE 2: CAPITAL ACCOUNT ACCOUNTING METHODS



The second adjustment, the Capital Account Ratio Adjustment, results in distributions to one or more partners. The first step is to divide each partner's capital account balance by the partner's capital account ratio. The second step is to rank the quotients. The third step is to subtract the next highest quotient from the highest quotient. The fourth step is to multiply the difference by the highest quotient partner's capital account ratio. The fifth step is to distribute the product's dollar amount to the highest quotient partner. At this point, the highest and next highest quotient partners' respective capital accounts are reconciled to (Ratios, Balances) method indifference.

The resulting Treasury Regulation Sec. 1.704-1(b)(3)(i) and (ii) compliant (Per Capita: Balances: Ratios) method truncated transitivity has the effect of rendering all Treasury Regulation Sec. 1-704.1(b)(2)(iii) insubstantiality tests as moot because such truncated transitivity inherently:

1. Fulfills economic effect equivalence compliance
2. Fulfills substantiality's general definition
3. Defines the *Vecchio* default basis for determining distributive shares according to the partners' interests in the partnership

Thus, when Per Capita method rebuttal reconciles as endowed with equitable substantial business purpose, and not tax avoidance motives, the partner's interest in the partnership is thereby determined. Moreover, the partners' distributive shares will be accordingly determined notwithstanding insubstantiality.

Substantiality's Conclusive Presumption

The advantage of substantiality's conclusive presumption is that it forecloses IRS equitable challenges. Taxpayers should fashion partnership special allocations as transitory allocations. The transitory allocations insubstantiality test includes an important exception:[22]

> "[T]the original allocation(s) and the offsetting allocation(s) will not be insubstantial and . . . *it will be presumed* that there is a reasonable possibility that the allocations will affect substantially the dollar amounts to be received by the partners from the partnership if, at the time the allocations become part of the partnership agreement, there is a strong likelihood that the offsetting allocation(s) will not, in large part, be made within five years after the original allocation(s) is made (determined on a first-in, first-out basis)."

Transitory allocations involve an originating allocation and equally offsetting allocations.[23] When the majority of the offsetting allocations occur more than five years after the originating allocation, a substantiality conclusive presumption arises. The value of the conclusive presumption is not to moot insubstantiality tests. Rather, it is to moot equitable challenges.

Black's Law Dictionary defines the conclusive presumption term:[24]

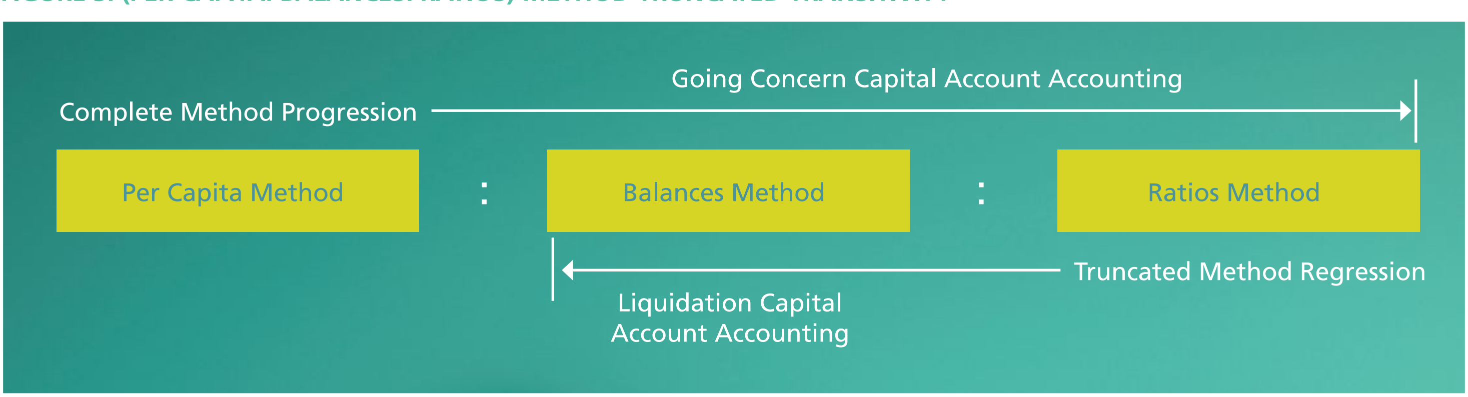
> "A conclusive presumption exists where an ultimate fact is presumed to be true upon proof of another fact, and no evidence, no matter how persuasive, can rebut it."

Conclusive presumptions are not unusual in tax cases. The Ninth Circuit's decision in *General Investment Corporation*[25] is instructive. There, the appellate court held that Congress provided a statutory conclusive presumption in the setting of Sec. 530 of the Revenue Act of 1978.[26] Analogously, once the taxpayer meets a credible evidence burden of showing offsetting allocations occur more than 5 years after the originating allocation, substantiality is conclusively presumed, is not rebuttable, and the IRS may not challenge substantiality on any equitable grounds.[27]

Conclusion

This article demonstrates that method truncated transitivity and substantiality's conclusive presumption simplify substantial economic effect regulatory compliance. Savvy practitioners realize as much. "Simplifying partnership special allocations regulatory compliance by conjoining (Per Capita: Balances: Ratios) method truncated

FIGURE 3: (PER CAPITA: BALANCES: RATIOS) METHOD TRUNCATED TRANSITIVITY



transitivity with substantiality's conclusive presumption enables vast numbers of startup transactions that would otherwise go unfunded," says Carla J. Keegan, CPA, CFE, CIRA, CFF.[28] "It is important for practitioners to embrace partnership allocation strategies for the benefit of their clients," Keegan concludes. EA

...WHILE ECONOMIC EFFECT TRINITY'S SECOND PRONG REQUIRES LIQUIDATION BY POSITIVE ACCOUNT BALANCES, IT DOES NOT REQUIRE LIQUIDATION BY EQUAL POSITIVE CAPITAL ACCOUNT BALANCES.

About the Author

David Randall Jenkins, Ph.D., received his Doctorate in Accounting and a Master's in Accounting with an emphasis in tax from the University of Arizona. He has taught financial, managerial, and tax accounting courses at both the graduate and undergraduate levels. Dr. Jenkins is an AACSB academically qualified business school and tax professor owing to his peer reviewed journal article publications. His company, Algorithm LLC (algorithm-llc.com), is an IRS-approved continuing education provider. Dr. Jenkins may be contacted at tucjenkins@aol.com.

To learn more about this topic, visit the NAEA Forums.

ENDNOTES

[1] See, http://www.irs.gov/Businesses/Partnerships/Partnership---Audit-Technique-Guide---Chapter-6---Partnership-Allocations-(Revised-12-2007).

[2] Collins is located in the lender's Phoenix, Arizona office and can be contacted at ticollins@thebancorp.com.

[3] See, *e.g.*, E. R. Haden, "The Final Regulations Under IRC Sections 704(b) and 752: Envisioning Economic Risk of Loss Through A Glass Darkly," *Washington and Lee Law Review*, Vol. 49, Iss. 2, 1992, pp. 487-528., at p. 505.

[4] See, *Vecchio v. Commissioner*, 103 T.C. 170, 189 (August 15, 1994); *citing*, T.D. 8065, 1986-1 C.B. 254. Also, see, Haden (1993) at note 3, *supra*.

[5] *Ibid*; *citing*, Treasury Regulation Section 1.704-1(b)(2)(ii).

[6] *Ibid*; *citing*, Treasury Regulation Section 1.704-1(b)(2)(iii).

[7] See, *Vecchio*, *supra*, at 193.

[8] See, Treasury Regulation Sections 1.704-1(b)(2)(ii)(b)(1) and (b)(2)(iv).

[9] See, Treasury Regulation Section 1.704-1(b)(2)(ii)(b)(2).

[10] See, Treasury Regulation Section 1.704-1(b)(2)(ii)(b)(3).

[11] See, Treasury Regulation Section 1.704-1(b)(2)(iii).

[12] See, Treasury Regulation Sections 1.704-1(b)(2)(iii)(a), (b), and (c); Haden, supra, at note 3.

[13] See, Treasury Regulation Section 1.704-1(b)(2)(iii)(a).

[14] See, Treasury Regulation Section 1.704-1(b)(2)(iii)(b).

[15] See, Treasury Regulation Section 1.704-1(b)(2)(iii)(c).

[16] See, Treasury Regulation Section 1.704-1(b)(3)(i).

[17] *Ibid*.

[18] See, Treasury Regulation Section 1.704-1(b)(3)(ii)

[19] See, note 9, *supra*.

[20] See, Treasury Regulation Section 1.704-1(b)(2)(ii)(i)'s definition of economic effect equivalence.

[21] In most cases, economic effect trinity's *Ex Post* Liquidation Capital Account Deficit Restoration third prong, although necessary to include in the partnership agreement, will not result in further contributions to the partnership. Economic effect trinity's third prong requirement does not preclude *Ex Ante* Liquidation Capital Account Deficit Restoration as a pre-liquidation capital account adjustment.

[22] Treasury Regulation Section 1.704-1(b)(2)(iii)(c)(2) *(Emphasis added)*.

[23] Originating and offsetting allocations implicate GC-CAM and do not affect LIQ-CAM.

[24] See, H. C. Black, *Black's Law Dictionary*, 6th Ed., West Publishing Co., St. Paul, Minnesota (1990), at p. 290.

[25] 823 F.2d 337 (9th Cir. 1987).

[26] *Ibid.*

[27] *Ibid.*

[28] Keegan is the President of Keegan, Linscott & Kenon, PC, a Tucson, Arizona Certified Public Accountant firm. Keegan is also an adjunct graduate tax professor at the University of Arizona Eller School of Management. Keegan can be contacted at ckeegan@klkcpa.com.

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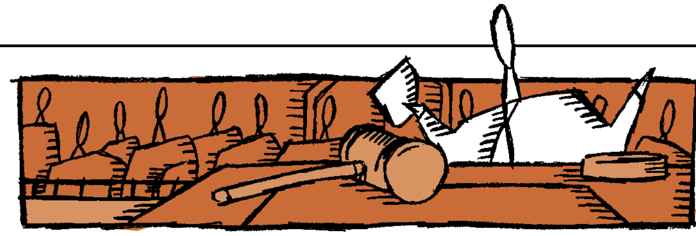

When is a Secondary Residence Converted into a Property Held for the Production of Income?

Robert I. Redisch and Pamela A. Redisch, Petitioners
v.
Commissioner of Internal Revenue, Respondent
T.C. Memo. 2015-95

By Steven R. Diamond, CPA

Whether or not an individual converts his personal property to one held for the production of income is a question that depends on the intention and circumstance of the individual. For a converted residence, the Tax Court tends to look at five factors, with no one factor being determinative.

These factors are:
(1) the length of time the house was occupied by the individual as his residence before placing it on the market for sale;
(2) whether the individual permanently abandoned all further personal use of the house;
(3) the character of the property (recreational or otherwise);
(4) offers to rent; and
(5) offers to sell"[1]

FACTS

In April 2004, Mr. and Ms. Redisch (petitioners) purchased an oceanfront condo (Porto Mar property). The Porto Mar property was a seasonal home and the petitioners never intended for it to be their primary residence. After purchasing the Porto Mar property, the petitioners made some cosmetic changes such as painting and decorating the condo.

The petitioners purchased the Porto Mar property for their personal use and often invited their daughter join them. Unfortunately, their daughter passed away in 2006. After that, the petitioners decided they could no longer stay in the condo and in 2008, they decided to rent it out. They believed they could sell it later for a profit and in the meantime, generate cash for the short term.

Mr. Redisch contacted a realtor from Hammock Dunes Real Estate Co. to assist him in renting the property. Most of the company's realtors lived within the community where the Porto Mar property was located and Mr. Redisch felt they would be best suited to rent out the condo. The realty company also operated an information center within the community, staffed by realtors who provided information and tours to potential buyers. The petitioners intended to rent out the condo under a one-year lease. This included the option to assume their golf membership.

The petitioners stopped staying at the Porto Mar property after their daughter passed away. In April 2008, they removed most of their personal belongings from the unit. They did not return to the condo partly due to the memory of their daughter and partly because they agreed to make it available to the realty company to show at any time. The petitioners were not paid to keep the condo available as a model, but the realtors would let prospective clients know that it was available to rent. The condo was also

About the Author

Steven R. Diamond is a CPA with a tax practice located in Westport, Connecticut. His practice is limited to compliance issues and representation before the IRS. He has his M.S.M. degree in taxation from Florida International University, and he is admitted to practice before the United States Tax Court. Steven also taught a course preparing EAs and CPAs to take the Tax Court admission exam for non-attorneys.

featured in a portfolio of rental properties in the company's office. There was no evidence to show that the realtors attempted to market the condo outside of the Hammock Dunes community.

The petitioners received inquiries from two potential renters. However, neither rented the property. Due to the lackluster interest in the property, the petitioners listed the property for sale with a different realtor in June 2009. They still hoped to rent it out, but also considered other options such as selling or leasing with an option to buy. In December 2009, the petitioners took the property off the market in order to obtain an appraisal to price it competitively. In December 2010, they sold the property and furnishings for $805,000.

The petitioners filed joint federal income tax returns for 2009 and 2010 which were prepared by a paid return preparer. The tax returns included a Schedule E which claimed deductions related to the Porto Mar property. The tax returns were examined and on November 12, 2012, the Commissioner issued a notice of deficiency making several adjustments. The petitioners filed a timely Tax Court petition and amended it, claiming that the sale of the Porto Mar property should have been reported as an ordinary loss instead of a long-term capital loss as originally reported.

OPINION

Generally, individuals are not allowed a deduction for personal, living, or family expenses. However, pursuant to IRC Sec. 212, an individual can deduct all ordinary and necessary expenses paid or incurred during the taxable year for the management, conservation, or maintenance of property held for the production of income. The individual has the burden of proving a conversion to a profit-motivated purpose occurred, and that the "burden cannot be satisfied if the profit-motivated purpose was secondary to another purpose not motivated by profit".[2] Furthermore, IRC Sec. 165(a) allows a deduction for any loss sustained during the taxable year that is not otherwise compensated. Notwithstanding, in the case of an individual, the loss must be incurred in a trade or business, be incurred in a transaction entered into for profit, or arise from a casualty or theft.

After considering the facts and circumstances as well as testimony provided by Mr. Redisch, the Tax Court held that the Porto Mar property was not converted to rental use. The petitioners used the property for four years before abandoning personal use of it in April 2008. Mr. Redisch testified that the efforts of the realty company to rent the property were limited to featuring it in a portfolio kept in the company's office and by telling prospective buyers that it was available when they showed it as a model. Mr. Redisch did not testify regarding any other tactics that he employed to rent out the property other than changing real estate agents. Likewise, he was not able to demonstrate that there were any actions taken by the second realty company to rent out the property, other than to list it with a multiple listing service. Consequently, the Court determined that the petitioners did not make a bona fide effort to rent out the property and therefore did not convert it to one held for the production of income. As a result, they were not entitled to take deductions under IRC Sec. 212 nor were they entitled to take a loss deduction under IRC Sec. 165. EA

ENDNOTES

[1] *Grant v Commissioner*, 84 TC at 825; *Newcombe v. Commissioner*, 54 TC 1298, 1300-1302 (1970)

[2] *Murphy v. Commissioner*, T.C. Memo. 1993-292

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U.S. TAX IMPLICATIONS OF FOREIGN INCORPORATIONS

1. A foreign subsidiary is a _________ chartered abroad to locally conduct foreign operations.
A. Domestic corporation
B. Foreign partnership
C. Foreign corporation
D. Domestic partnership

2. Tax-free domestic incorporations under IRC Sec. 351 also apply to foreign incorporations.
A. True
B. False

3. The _________ rules of IRC Sec. 367 are designed to deter taxpayers from shifting potential income of U.S. impetus outside the U.S. taxing jurisdiction.
A. Anti-recognition
B. Deferral
C. Anti-deferral
D. Anti-nonrecognition

4. The major exception to the general rule of IRC Sec. 367 allows for gain nonrecognition whenever the transferred assets are legitimately meant for _________ in an active trade or business outside the U.S.
A. Sale
B. Use
C. Asset protection
D. Storage

5. During the transfer of assets in an outbound incorporation, the law requires recapture of certain previously claimed U.S. tax benefits to the extent gain is _________.
A. Avoided
B. Deferred
C. Recognized
D. Realized

CAREGIVER CALAMITIES

6. Caregivers can always be written-off as a medical expense as long as they are cooking, cleaning, and taking care of an old person.
A. True
B. False

7. A family that has paid a caregiver "off-the-books" for years can legally avoid paying back payroll tax by claiming the statute of limitations has run-out.
A.True
B. False

8. In addition to IRS denying medical expenses for an improperly reported domestic employee, the DOL and SSA can also go after payroll tax, unpaid over-time, and SS tax.
A.True
B. False

9. Which agency is interested in the employment status of domestic employees?
A. Social Security Administration
B. Department of Labor
C. Internal Revenue Service
D. All of the above

10. A domestic employee's taxes may be paid at the end of the year using Schedule H.
A.True
B. False

11. In order to deduct caregiver expenses as medical deductions, a doctor must prescribe that the individual being cared for is unable to perform two or more activities of daily living. This assumes the income was properly reported on a W-2 Form.
A.True
B. False

12. How should you report income paid to a full-time caregiver?
A.On Form 1099-MISC
B. Pay them in cash and don't report it at all
C. On Form W-2
D. None of the above

13. In order to deduct caregiver costs as medical expenses, you must do the following:
A. Pay the caregiver on a W-2 basis and have the proper doctor certification
B. Cancel checks to the Caregiver
C. Only count costs accumulated from days the caregiver transported patient to and from the doctor's office
D. Pay caregivers on a 1099

SIMPLE SUBSTANTIAL ECONOMIC EFFECT REGULATORY COMPLIANCE

14. Why is the (Per Capita: Balances: Ratios) capital account accounting method progression not completely transitive?
A. Liquidation by positive capital account balances is not required to be equal on a per capita basis
B. Substantiality's conclusive presumption cannot be rebutted by the IRS
C. Congress did not expressly require such transitivity in the plain reading of Section 704(b)
D. The Ninth Circuit's *General Investment Corporation* decision holds such transitivity is not within the intent of Congress
E. Capital account deficit restoration requires originally allocated deductions must be repaid with cash contributions if liquidation occurs within five years of the originating allocation

15. What is the necessary predicate enabling substantiality's conclusive presumption?
A. There is a strong likelihood the offsetting allocations will occur more than five years after the originating allocation
B. All offsetting allocations must occur within five years after the original allocation
C. There is a reasonable possibility the allocations will substantially affect the amount of dollars the partners receive from the partnership, independent of tax consequences
D. The bank providing the financing agrees with the offsetting allocations period and method

16. Which of the following is not among the Per Capita method rebutting factors?
A. The partners' relative contributions to the partnership
B. The interests of the partners in the economic profits and losses
C. Balances method
D. The interests of the partners in cash flow and other non-liquidating distributions
E. The rights of the partners to distributions of capital upon liquidation

17. What can be said about partner capital account balances under the Per Capita method?
A. They are always equal
B. They are always unequal
C. They are always equal except when there are disparate capital contributions
D. They are always equal except when there are special allocations
E. They are always equal because special allocations are always deemed insubstantial when the Per Capita method is used

18. Disparate capital contributions invoke departure from the Per Capita method to what capital account accounting method?
A. Balances method
B. Ratios method
C. Going Concern method
D. Liquidation method
E. Substantiality method

TAX COURT CORNER

19. In the Redisch case, the Tax Court ruled that the petitioners were able to claim deductions under IRC Sec. 212 because:
A. They had converted the property to a property held for the production of income
B. The statute of limitations does not bar an individual from claiming deductions under IRC Sec. 212
C. They used a paid income tax preparer to prepare their tax returns and therefore had made every attempt to have the tax return comply with the Internal Revenue laws.
D. None of the above

20. The Tax Court determined that:
A. The real estate company did not make an effort to promote the property on behalf of the petitioners
B. The petitioners did not make a bona fide attempt to rent out the Porto Mar property
C. The petitioner's daughter had tragically passed away and therefore they deserved to have their tax return accepted as filed
D. None of the above

Pay It Forward

By June Lynham Pina, EA, and Sean Reed, EA

As enrolled agents, we excel at helping others. This is evidenced daily not only in our representation work, but also in volunteering our time to share our knowledge and love of the craft, mentoring tax colleagues. On social media, the "IRS Exam Study Group" is doing all that in one place.

In June 2012, Kristin Sampayan, EA, formed the Facebook group "IRS Exam Study Group" to seek out and help other unenrolled preparers pass the RTRP exam.

"It's always more motivating to study with other people. To know others are struggling with the same things you are and yet passing a test makes you realize you can do it too," Sampayan says. "When the RTRP was to be required of all tax preparers, several members of the Tax Pros group discussed helping each other study. I thought, *why don't we get a group going just for that purpose?* And so [began] the IRS Exam Study Group."

After a few members became RTRPs, the group expanded to EA study. Now, the group focuses solely on preparing for the EA Exam. Since inception, the group (now with over 830 members) has included students, tax practitioner coaches, and a cheering squad. With ample encouragement and guidance, every candidate is confident and well-prepared on the day of his or her exam. Upon completion, the group waits to hear the result of the exam. If an exam is failed, the candidate will be encouraged to get back on the horse and reschedule immediately. The coaches then focus on trouble areas to ensure the next exam will be a pass.

The IRS Exam Study Group has an active coaching core. Don Overstreet, EA, the lead coach, has taken teaching to new heights. He has prepared over 370 individual files, graphs, and spreadsheets for each part of the EA Exam. Additionally, Don works closely with several education vendors to secure the best possible prices on study materials for students. All coaches have a passion to "pay it forward" and help new candidates succeed.

In its first year, thirteen members of the study group become EAs, followed by forty-two in the 2014-2015 EA Exam testing cycle. That's an astounding fifty-six newly licensed enrolled agents in two years!

The group encourages its members—EAs or not—to join NAEA. Every potential candidate is given contact information for Michelle McBride, EA, co-chair of the NAEA membership committee, to learn more about member benefits and services.

The group does not ignore the individual efforts of EA Exam passers, but graduates have acknowledged the major role the group plays in candidate success. When asked what they thought of the group's contribution to their success, members had this to say:

*"I started studying on my own and it was a struggle. I cannot say enough about how much the study group/family helped by prodding and supporting me to become an EA. Their constant encouragement was life-saving." **-Rose Maio, EA***

*"The group gave me the support to handle the grueling process of passing the exams in 7 weeks! Without them, I would've felt alone." **–Tim Calloway, EA***

*"When the group was created, I joined to study for the RTRP exam. The support, respect, and dedication of this group was outstanding. English is my second language and, without business tax knowledge, I never thought I would pass the EA Exam. Thanks to this group, I passed not only the RTRP but the EA Exam. Today I'm an EA. This group is the BEST." **-Fatima Leguizamon, EA***

*"Until recently, the group was funded only by its admins who contributed enough to give some scholarship based on need, to acquire coaching materials from CE vendors, and to give small graduation gifts - EA t-shirts or mugs and sometimes, reimbursement of Form 23 fees. Recently, admins solicited non-deductible donations from members of 3 sister Facebook tax boards, funds that will be used to subsidize similar costs. The spirit and focus of the group is, and will continue to be, voluntary. As such, the effort stands second to none in the commitment to coach, support and encourage more tax practitioners to achieve the only Federal license available to the industry." **– Enrolled Agent.***

We encourage all NAEA members to join the IRS Exam Study Group on Facebook. There is nothing more rewarding than giving back to the EA community and helping others pass the EA Exam by sharing tips, tricks, and encouragement. Everyone has something unique to offer and every voice is valued. With your help, we can foster the next generation of enrolled agents! **EA**

About the Authors

June Lynham Pina, EA, is the President of Ameritax Professionals Inc., a 12-office, full-service, year-round, Massachusetts tax firm. After moving to Massachusetts in 1975, she entered private practice, leaving in 1989 to work for Tax Man Inc., a large independent Massachusetts firm. When Tax Man was sold to a national chain in 2005, she returned to private practice, founding Ameritax and its sister companies with the help of many of her Tax Man colleagues.

Sean Reed, EA, was born into the world of taxes after his grandfather started a tax service in 1943. After 20 years of working in the financial services industry, he returned to his family's practice. Passing all three parts of the enrolled agent exam in 2013, Sean seeks to "pay it forward" and help others achieve their goals of becoming EAs.



THE WAY TO EA

BY JULIA SHENKAR






"IT IS NEVER TOO LATE TO BE WHAT YOU MIGHT HAVE BEEN." -GEORGE ELIOT

When I graduated from a small liberal arts college with a dual degree in French and non-fiction writing, my parents asked what I planned to do with my life.

"I have the rest of my life to figure out what I want to be when I grow up," I told them.

After speaking with some of NAEA's members, it seems this philosophy is not purely my own. Finding one's niche in the work force is a journey with twists, turns, and challenges that shape us as professionals. The positions we hold allow us to discover our true passions, inspire us, and present us with unique opportunities that prepare us for what's ahead. From forensic chemistry to deep-sea fishing, military service to the Indy 500 pit crew, our members have done it all before settling into a careers as enrolled agents.

Of the members I interviewed, almost everyone cited clear, concise communication and presentation skills as an essential quality for an EA. Conrad Mangapit, EA, used the great analogy of a movie preview when characterizing the relationship between an EA and his or her client. Presentation is everything and the preview has only a few minutes to convince the moviegoer to see the advertised film.

"When you meet a prospective client for the very first time," he says. "That prospective client will make a decision to trust you to prepare their tax return or represent them before the IRS."

Those first few moments are key, and Mangapit credits his experience as a marketing manager and a business unit manager for Toshiba with his fierce ability to make a solid first impression. During his tenure at Toshiba, his philosophy was "No Customers = No Business." He learned to create dynamic marketing plans that catered to the needs of his customers and recognized the power of strong interpersonal communication. As an enrolled agent, Mangapit is required to use these same skills to build strong, trusting relationships with his clients. Getting to know each individual's needs allows him to provide the customer with a quality experience, ensuring solid client retention. If his business were a movie, Mangapit would break box office records.

NAEA President, Terry Durkin, EA, is an EA legacy. Durkin's mother was an enrolled agent–she was even one of the founding members of the Massachusetts Society of Enrolled Agents. "I grew up around enrolled agents," Durkin says. "I understood the business from working with my mother." Though not a career in its own right, being the daughter of an active enrolled agent gave her valuable insight that is not available to everyone. Before taking over her mother's business in 2005, Durkin worked as a product manager for IBM. There, she was faced with a variety of customers with varying needs. It was often challenging to juggle customer expectations, while keeping in mind what was technically possible to produce. Switching over to a career as an EA, Durkin was well prepared to manage her clientele, ensuring they understood what could and could not be done. Her experience at IBM, paired with the knowledge gained from working with her mother, makes Durkin a model enrolled agent. Her best advice to future EAs? "Find a mentor or two"–and what better mentor than your own mother?

Speaking of mothers, that is something Christina Whearley, EA, always wanted to be. As an enrolled agent, Whearley uses her experience as a mother of four to her advantage. "I have worn many hats," she says. "… A chauffer, personal chef, referee, even therapist!" Transitioning seamlessly from role to role can be challenging, but necessary in order to satisfy the needs of each child. In a way, Whearley sees her relationship to clients in the same light as she sees her relationship to her children.

"I have knowledge they lack, and sometimes they just need a teacher to educate them [or] a counselor to listen and understand their fears and frustration about their tax situation," she says. "And that is what is the most rewarding."

The ability of an EA to be thick-skinned, persistent, and flexible is essential. Difficult phone calls with the IRS may lead to frustration or feelings of hopelessness. On top of that, arduous clients can test your ability to stay calm, cool, and collected. Edward Moore, EA, recalls his time as a forensic chemist (an occupation he holds in addition to being an enrolled agent) and the hurdles of communicating with jurors. "When I testify in court, I have to explain complex scientific concepts and distil them so the average juror can understand," says Moore. For enrolled agents, transposing tax code to laymen's terms can be a struggle. Moore finds he has to approach clients in the same way he approaches jurors, making sure he has all the information he needs and translating that for their defense.

As an engineer, Bill Nemeth, EA, made his living thinking outside the box. He was required to keep a positive, can-do attitude while closely analyzing every piece of the puzzle. Thinking ahead, seeing the larger picture, and coming up with original solutions to vexing questions were daily requirements in Nemeth's engineering days. It is no surprise to him that those skills have carried over as an EA. The ability to solve problems comes naturally to him, and he utilizes that strength each day as an enrolled agent – especially when it comes to audits.

"Audits become an interesting high-stakes game of wits," he says. "I [am] always trying to out-maneuver the auditor…"

Though enrolled agents may do their work seated at a desk, their minds are running a mile a minute, jumping through hoops, and digging deep for answers to every kind of tax-related question.

Each of NAEA's members has a colorful background both in and out of taxation. Their résumés are unique and filled with moments that paved the way for success as enrolled agents. Finely tuned skills in communication, problem solving, and flexibility have made their practices thrive and our members will be the first to tell you they owe it all to their past experiences.

As a young professional just starting her occupational journey, I am inspired by the experiences of our members. Humbled and reassured, I know that my first job may not be the only one I'll have – not that working at NAEA isn't great! – and that the career I settle into may be worlds different from my previous positions.

NAEA's members have got me thinking more… Hmm, I'm a swimmer. Maybe I'll try pearl diving? **EA**

About the Author

Julia Shenkar is *EA Journal*'s managing editor and NAEA's communications manager.

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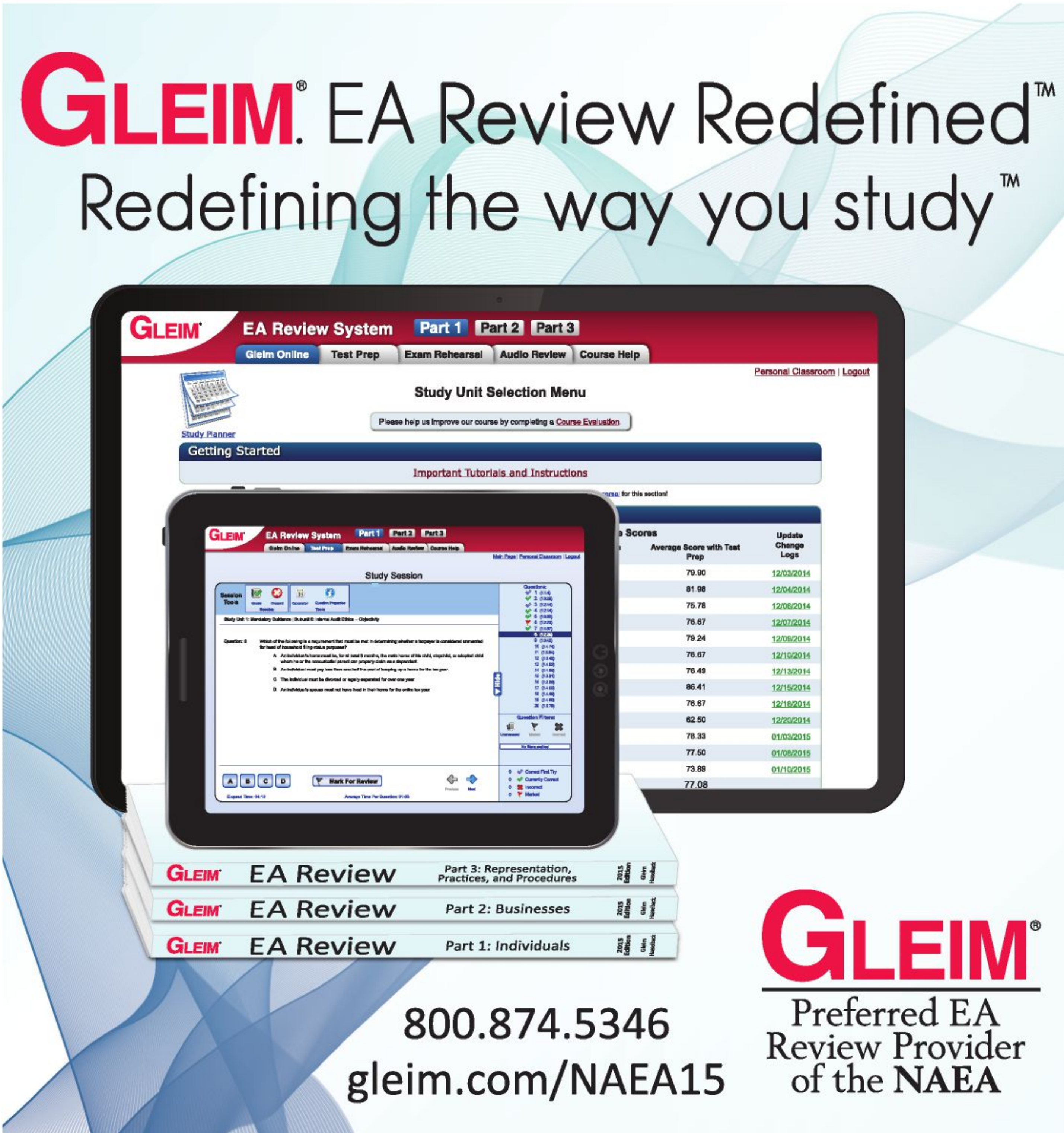

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