

NAEA 2017-2018 Election • 2016 Tax Law Wrap-Up • R&D Credit

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# EA JOURNAL

WWW.NAEA.ORG THE NATIONAL ASSOCIATION OF ENROLLED AGENTS

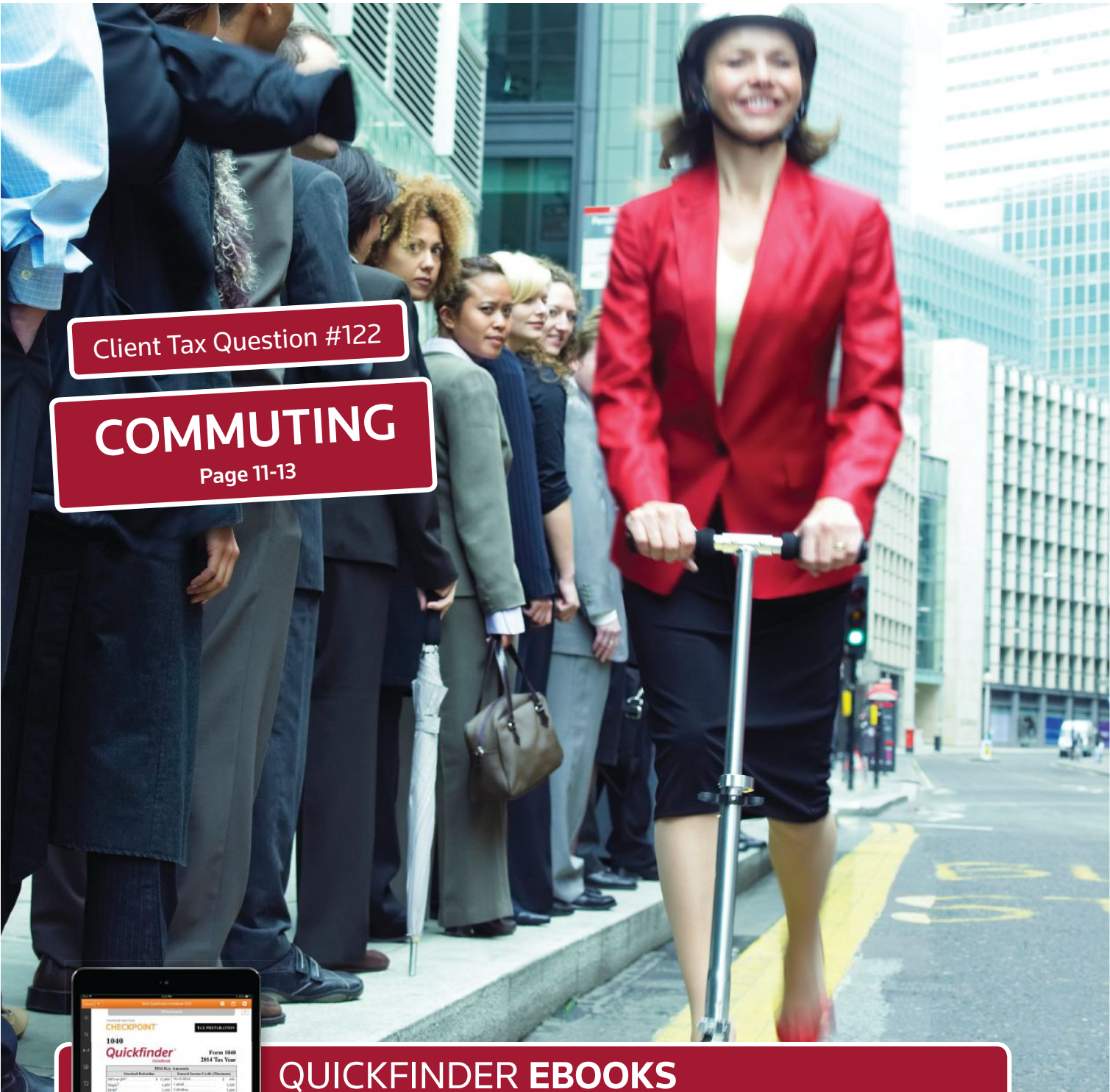


## UNDERSTANDING THE PFIC RULES

*and the Implications of Owning Foreign Mutual Funds*

President's Message • Capitol Corner • Tax Court Corner  
Tax Appointment Worksheet • 2016 National Conference Highlights

**NAEA**  
POWERING AMERICA'S TAX EXPERTS



Client Tax Question #122

**COMMUTING**  
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# EA JOURNAL

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# Cast Your Vote



Richard Reedman, EA, USTCP

A few years back, "synergy" was one of the most over-used buzzwords in business. This much-maligned phrase was often used in conjunction with "core competency," "deep dive," "low-hanging fruit" and "proactive."

Defined simply, synergy is the creation of a whole that is greater than the simple sum of its parts. This describes perfectly my view of NAEA. We know that our ability to make positive changes at IRS and Capitol Hill is dramatically enhanced when we can speak with one voice. Our efforts to raise the public profile of enrolled agents are more effective when all of us promote ourselves as "America's tax experts." NAEA is an association of many disparate individuals whose divergent opinions and dissimilar backgrounds require that we look at association issues in a variety of ways. Examining issues, as opposed to simply agreeing, forces us to examine our choices instead of just accepting the status quo.

December 1-15, NAEA members will have the opportunity to vote for individuals who will be part of the 2017-2018 NAEA Board of Directors. For the next year, these men and women will be your representatives in determining the direction of the association. Because this association represents all of us, each of us bears the full responsibility to participate in its crucial decision making. As members, each of us needs to show that we own this association, and that we are willing and able to take its future into our own hands by carefully considering the nominees and candidates who are now asking us to allow them to lead.

In this issue, you'll find a report from this year's Nominating Committee, led by Immediate Past President Terry Durkin, EA. If you haven't yet been a part of the

nomination process or run for office, I think you may be surprised by the thorough process of questioning and deliberation that goes into choosing the slate of nominees. Our bylaws also permit qualified members who have been through the process to "run from the floor." I'm proud to state that NAEA has a terrific history of member involvement, with so many members willing to spend significant time working to make our association better, stronger, and smarter. The more participation in the process, the better and more focused we can become. This evolution starts now; please vote for your representatives to lead our association.

The Nominating Committee has done its part. Those running for office are doing their part. Now, it's your sincere participation that is necessary to make this election what it needs to be to reflect your needs and desires. Today, I'm asking you to take time out of your lives to read the biographies of the nominees and candidates, their statements of goals and answers to the common question. You may have known some of these individuals for years; still, you may be surprised by some of their views on the direction of the association. The knowledge you gain by paying close attention right now may affect the way in which you cast your votes.

Thank you in advance for putting forth the effort to make your vote count. NAEA is a world-class organization in great part because of the high level of engagement among our members. EA

# 2016 NOMINATING COMMITTEE REPORT



By Terry Durkin, EA (Chair); Lori Carpenter, EA; Lonnie Gary, EA, USTCP; Jeff Gentner, EA; Patti Kappen, EA; Beth Keppel, EA; Rich Rhodes, EA

The Nominating Committee is pleased to report that this year we had over 100 total nominations for 46 unique members. Of those 46 members nominated, 20 members decided to follow through with the interview process. These 20 members filled out a leadership profile questionnaire (LPQ), which is a comprehensive questionnaire designed to determine an individual's qualifications for the position(s) desired and his or her views on issues of importance to NAEA and our EA profession. The Nominating Committee conducted interviews August 1–3 in conjunction with the 2016 National Conference, held at the Cosmopolitan Hotel in Las Vegas, Nevada. The committee considered many factors during the interview and deliberation phases, including the future leadership needs of the NAEA Board. Every member interviewed by the committee brought a set of strengths that made our decisions difficult and rewarding. Our membership should be proud that so many talented members want to serve on our board of directors. Any member who completed an LPQ and was interviewed by the committee but was not selected as a nominee is eligible to "run from the floor" as a candidate in the election.

The Nominating Committee sought to nominate the best qualified leaders for the positions to be filled. NAEA bylaws direct us to select one person, but not more than two persons, for each open officer and director position. The three open officer positions are president-elect, secretary, and treasurer. There are four open director positions. This is a transition year with the secretary and treasurer positions being separate positions. The term for treasurer will be two years. In this election cycle, the secretary position will be one year (in the next election cycle the secretary position will be two years).

After numerous interviews, including three teleconference interviews and lively deliberations, the Nominating Committee is proud to present the following nomination slate:

**PRESIDENT-ELECT**  
Jean Nelsen, EA

**SECRETARY**  
Angela Radic, EA

**TREASURER**  
Tim Dilworth, EA, CPA

**DIRECTOR**  
Jeff Augenstein, EA  
Chris Hardy, EA  
Jake Johnstun, EA  
Joyce Mohr, EA  
Don Rosenberg, EA

In addition to the nomination slate, the following members are running from the floor as candidates:

**SECRETARY**  
Nancy Lyman, EA

**DIRECTOR**  
Roger Garay, EA  
Twila Midwood, EA  
David Tolleth, EA

This report completes the work of the 2016 Nominating Committee. However, all of us as members now have the final say on our next crop of NAEA leaders. I urge you to make an informed vote. Contact the nominees/candidates if you have any questions on their qualifications/vision for NAEA. Please exercise your right to vote in December. The vitality of our organization depends on your engagement in this process.

NAEA is using the services of a professional election company for this process. Eligible members (those in good standing with NAEA as of November 1, 2016) will be able to cast their vote electronically. There are no longer any paper ballots. All members will receive an awareness message in early November. On December 1, members will receive a message providing a unique URL taking them directly to the electronic ballot. The election will run from December 1–15. When the results have been finalized, the new directors and officers will be announced in *E@lert*. The biographies, statements of goals, and answers to the common question for the nominees and candidates found on the following pages will also be accessible via the electronic ballot.

It was my honor to chair this group of consummate professionals who were willing to donate many hours of their time to select a nomination slate worthy of our members' support. Our journey began last May with numerous phone calls and culminated with an intense multi-day interview schedule in Las Vegas. I wish to thank Lori, Lonnie, Jeff, Patti, Beth, and Rich for their unique perspectives and talents they brought to this process. I also wish to thank Cedric Calhoun, our staff liaison and executive vice president, for his support to ensure our committee ran smoothly. If you have questions about the voting process, please contact NAEA EVP Cedric Calhoun at [ccalhoun@naea.org](mailto:ccalhoun@naea.org) or at 202-822-6323 x101. Please contact Creative Scanning Solutions, Inc. at [elections@cssconsult.com](mailto:elections@cssconsult.com) or at 585-377-4235 if you have any problems voting.

## National Association of Enrolled Agents 2017-2018 Election

To cast a vote:

- Check the box next to the nominee/candidate name.
- To change your vote, click the box again and the mark will be removed.
- To review candidate information, click on the candidate name.
- Once you have completed your selections, click the "Submit" button at the bottom of the page.

### President-Elect (Vote for one)

- Jean Nelsen, EA - Nominee

### Secretary (Vote for one)

- Nancy Lyman, EA - Candidate  
 Angela Radic, EA - Nominee

### Treasurer (Vote for one)

- Tim Dilworth, EA, CPA - Nominee

### Director (Vote for up to four)

- Jeff Augenstein, EA - Nominee  
 Roger Garay, EA - Candidate  
 Chris Hardy, EA - Nominee  
 Jake Johnstun, EA - Nominee  
 Twila Midwood, EA - Candidate  
 Joyce Mohr, EA - Nominee  
 Don Rosenberg, EA - Nominee  
 David Tolleth, EA - Candidate

**SAMPLE**

Submit



**JEAN NELSEN, EA**  
**NOMINEE FOR PRESIDENT-ELECT**

**BIOGRAPHY**

I am Jean Nelsen, owner of Jean Nelsen, Enrolled Agent. My firm is located in San Francisco, California. We are a company of five talented professionals: two EAs, one aspiring EA, one CPA candidate, and one tech advisor.

In addition to running the firm, I have been active in my affiliate, CSEA. I have served as president, first and second VP, chair of the Ethics and Professional Conduct Committee, representative to the California Franchise Tax Board Advisory Board and the IRS practitioner liaison. I also served as CSEA Education Foundation President. I served my chapter, Golden Gate, in multiple capacities including president.

I currently serve NAEA as a member of the board of directors and chair of the Educating America Task Force. My past service includes the Nominating Committee, two terms on the EVP Search Committee (one term as chair), chair of the Ethics and Professional Conduct Committee, and one term on the NAEA Education Foundation. I am also the 2014 co-recipient of the NAEA Excellence in Public Awareness Award. I am honored to be chosen as the nominee for the office of president-elect, and I look forward to serving you, the members of NAEA.

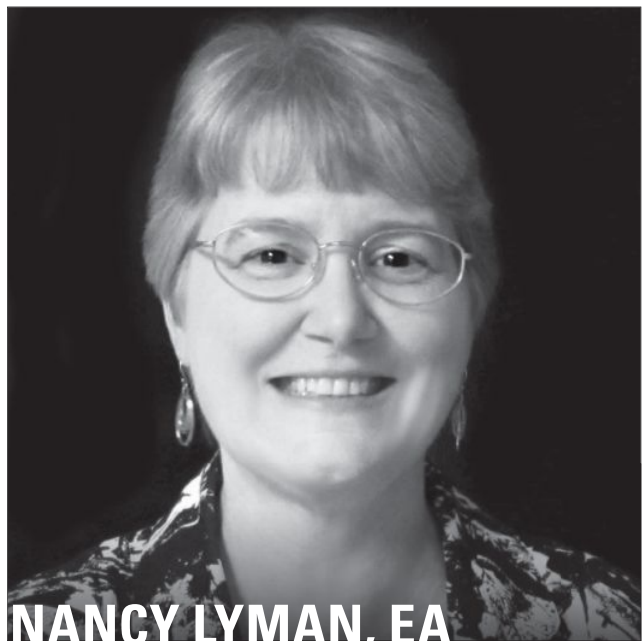
**STATEMENT OF GOALS**

I believe that NAEA needs to focus on:

1. Financial stability. We must develop resources to fund new programs for members.
2. Protecting our right to practice. The EA license is my most valuable asset. Protecting this asset is the reason I support the NAEA PAC at the congressional level.
3. Promoting the EA license to unenrolled preparers. Enrolling new members requires interaction with both individuals choosing their professional designation and licensed EAs who are looking for ways to make their careers more visible. While we aren't going to convince every accounting student to become an EA, we can educate every student and administrator on the value of the enrolled agent. Partnering with professional organizations for continuing education that includes immediate employment or trained employees is another benefit we are exploring at NAEA. No other organization offers a combined education/employment benefit.
4. Promoting NAEA membership. I support the Member Get a Member campaign, and I think that it will be effective as a program for member retention. We must be creative, with targeted marketing when approaching non-member EAs.

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

The most important NAEA strategic goal that I support is recognition of enrolled agents. This is Goal #1 in the current strategic plan and should remain our top priority. Expanding the recognition of the EA license will increase NAEA membership and ensure our financial stability.



**NANCY LYMAN, EA**  
**CANDIDATE FOR SECRETARY**

**BIOGRAPHY**

For the last 30 years, I've worked in a professional CPA firm, which has allowed me to gain extensive tax and financial statement experience. The firm encouraged me to become an enrolled agent and join NAEA in 1995. They supported my advancement in becoming a National Tax Practice Institute Fellow® in 2007. I am a 2011 graduate of the Schuldiner/Smollan Leadership Academy. Since becoming an EA, I've served NNESEA in various elected positions, currently as the immediate past president. I am serving a second term as NAEA director and was elected by my peers to serve on the NAEA Executive Committee as director-at-large. I am the current chair of the Governance Committee and serve on the Finance and PAC Committees. My past service on the Public Awareness Committee, Public Relations Committee, Affiliate Council, Educating America Task Force and EVP Search Committee gives me unique insight into our history and lets me envision where we need to go.

**STATEMENT OF GOALS**

Use this opportunity to vote. As secretary, I will provide timely and accurate recordings of all business meetings to ensure effective administration of NAEA records. This is essential to increase transparency and keep NAEA leaders and members informed. My continuing board service and participation in the creation of our new strategic plan have strengthened my desire to serve the membership. The preparation and participation in board meetings is an essential part of representing the members' interests. I take this challenge seriously. We must attract new members through consistent and aggressive marketing techniques, extensive public relations, traditional and social media outreach, and taxpayer/practitioner advocacy. We must contact former members who have not renewed their membership to determine the reasons for them having left and endeavor to correct any perceptions that membership is not beneficial. We must improve, expand and promote NAEA's technological competency. We need to explore new ways to increase our non-dues revenue. Our members must be encouraged and empowered to promote themselves. The connections between NAEA and its affiliates are paramount to attracting new members. When connections are strengthened between the national and state levels, achieving our goals as a tEAM will be realized. I believe in what NAEA can do for its members. I want to continue to be your voice on the board!

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

In my opinion the most important strategic goal of the organization is the Organizational/Infrastructure and Financial Security. I support this goal and recognize the current financial trends of NAEA are a challenge. As a non-profit group, finances and membership go hand in hand to create a vital, growing organization.





**ANGELA RADIC, EA**  
NOMINEE FOR SECRETARY

**BIOGRAPHY**

I am the CEO and co-owner of Parker Tax Accounting in Gahanna, Ohio. Currently, I serve on NAEA's Board of Directors and Educating America Task Force. I am a proud supporter of the PAC.

I have been an active member at all levels of NAEA. I have attended the Schuldiner/Smollan Leadership Academy, the NAEA GR Fly-In Day, and APEX. Previously, I served on the Young Professionals Task Force and as a professional partner representative for Beta Alpha Psi.

I served as treasurer for both the Ohio State Society of Enrolled Agents (OSSEA) and the Greater Columbus Chapter (GCCOSSEA). I continue to serve as the social media chair for GCCOSSEA. I hold a BS in organizational behavior management from Miami University.

**STATEMENT OF GOALS**

Innovative thinking is essential for discovering new ways to interact with our members and provide resources that they, and prospective members, seek. NAEA must embrace the use of technology, and begin to view it as a method to enhance the value of membership.

While we explore technology and move towards data-driven decision making, we must not lose sight of the fact that the relationships that our members form within the organization are the glue that holds us together. By creating a welcoming environment at all levels of our organization and mentoring those who are new to our profession and NAEA, we can increase membership and encourage active participation. Educating America is an important first step to bringing new members in the door, but establishing personal connections will ensure that members are engaged and understand the value of NAEA membership.

As we reach for our goals of increasing awareness of our designation and bringing new members into the fold, we must examine each project and initiative with a critical eye toward our financial position. The passion and dedication of our members and the vision of the leaders who precede us have created an incredible organization for enrolled agents. We must ensure that the foundation of the organization is solid, so that we can continue to build toward the future.

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

Our focus must be turned toward Organizational/Infrastructure and Financial Security strategic initiatives. Now is the ideal time to examine our operations and determine where we can make changes that will benefit our financial position, without compromising the services and benefits that our members value.



**TIM DILWORTH, EA, CPA**  
NOMINEE FOR TREASURER

**BIOGRAPHY**

I believe my financial and accounting background make me especially suited to this position. I have a bachelor's degree in finance from the University of Utah and a master's in accounting and financial management from DeVry University. After eight years as tax manager of a mid-sized CPA firm in Michigan, I opened my own practice in Kalispell, Montana in January 2015. My extensive experience preparing and reviewing attested financial statements for business clients gives me the tools I need as treasurer.

I am the current secretary/treasurer of NAEA. I have also been on the board of the Great West Society of Enrolled Agents for the past two years. I have served NAEA on the board of directors (two years), Finance Committee (currently), Audit Committee (currently; three years), Reserves Task Force, and NTPI Planning Committee (two years). I served on the Michigan Society of Enrolled Agents Board of Directors for six years, including two years as president.

**STATEMENT OF GOALS**

My main focus as treasurer would be ensuring that NAEA is on solid financial footing. We are in the midst of a renewed commitment to financial stability with a new EVP and a newly formed Finance Committee in the past year. The recently formed Finance Committee, in conjunction with the treasurer, gives us a way to more closely monitor the financial condition of the association. I have been involved with this committee (originally a task force) from the beginning and will continue to use this collaborative effort to help improve our financial position.

As one of the architects of the current strategic plan, I support it completely. Our number one goal should always be increased enrolled agent recognition. Our second priority is membership. There's an old saying that "If you're not growing, you're dying." Our financial security is tied to membership and developing alternate sources of revenue. We need to continue to fuel growth by supporting initiatives such as Educating America, our plan to bring the EA profession to America's colleges.

This is a great program that will increase the number of EAs while also making the term more recognized among those who see the program in their schools. Another part of supporting membership is doing all we can to make things easier for the affiliates. I believe it is crucial to have a strong relationship between the board and the affiliates.

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

Our most important long-term goal is greater recognition of our credential. The short-term goals we have to meet—to ensure that the long-term goal is met—are financial security and increased membership. With financial security, we will be free to pursue greater recognition.



**JEFF AUGENSTEIN, EA**  
NOMINEE FOR DIRECTOR

**BIOGRAPHY**

I am the co-founder/president of Northern Arizona Financial Services, Inc., located in Flagstaff, Arizona. Since its inception in 2003, NAFS has grown to be a one-stop shop for clients providing the following services: tax representation for individuals and businesses, representation before the IRS, payroll, sales tax, bookkeeping, tax planning, and investments. I hold a business degree from Northern Arizona University and have successfully pursued the Series 6, 7, 63, and 65 licenses.

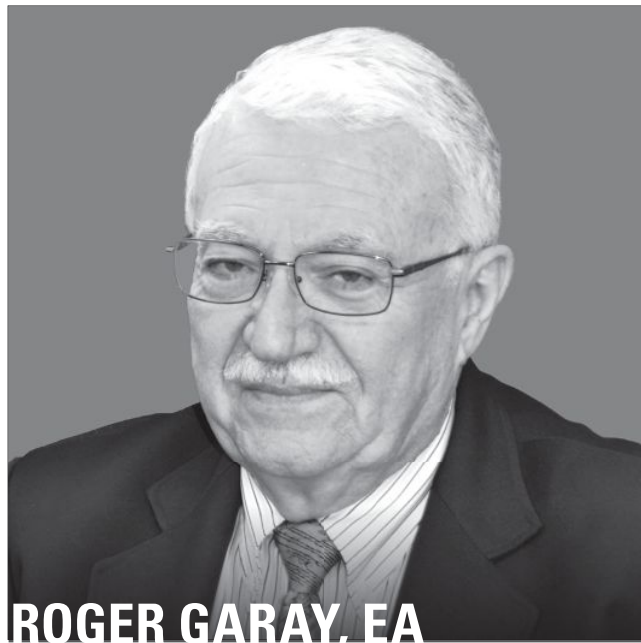
My interest in the tax field began in high school. Prior to establishing my own business, I worked for the better part of a decade for a well-known national tax chain. I have been an enrolled agent for 15 years and am an NTP1 Fellow, NAEA GR Fly-in Day participant, and a graduate of the Schuldiner/Smollan Leadership Academy. I am immediate past president of the AzSEA, a current member of the Government Relations Committee for NAEA, and a sought-after instructor for continuing education courses, teaching a wide range of subjects from employee/independent contractor issues and employment taxes to foreign tax issues and capital gains/losses.

**STATEMENT OF GOALS**

I am excited to be nominated for the position of NAEA director. I support NAEA's strategic plan, and feel that in order to execute the plan successfully we have to give affiliates the tools and resources to build strong leadership for the future. At the national level we can build mentoring programs for new and existing members. As we develop strong leaders, they will endorse the benefits of membership by building relationships among the affiliates. I have worked tirelessly through AzSEA to build strong relationships with other states. This has allowed all involved to share in mutual successes and solve problems that affiliates face from time to time. We have had the opportunity to share education events and presentations. The feedback from the affiliates I've worked with over the years should be brought to the national level to allow for development and collaboration to support our affiliates.

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

The most important strategic goal that I have and will continue to support is Member and Affiliate Services. I have seen NAEA advocate on the behalf of enrolled agents and taxpayers to an extent that no one else does; this is an incredibly valuable benefit of belonging to the NAEA family. I believe that by meeting the goals of increasing the value of membership and providing excellent customer service to our members and affiliates, a natural consequence will be an increase in membership and fellowship among our members. As director, I will work to identify members who can fill leadership roles, mentor new and existing members and keep NAEA strong.



**ROGER GARAY, EA**  
CANDIDATE FOR DIRECTOR

**BIOGRAPHY**

I hold a BS in electrical engineering, an MBA in engineering management, and an MS in business administration with a concentration in finance and marketing. Following six years of active duty military service during the Vietnam War, in which I attained the rank of captain, I held senior accounting and managerial positions at several different firms. Concurrent with this work, I was an adjunct professor of business and accounting (University of Redlands, University of Phoenix), seasonally employed by Intuit, and operated a small tax preparation solo-practice.

I became an EA in 1979. In 2002, Janet Ryan Morse, EA, and I purchased an existing business, On Line Bookkeeping & Tax Service, Inc., in Alpine, California. Since that time we have more than doubled our business (now serving over 1,250 clients) and been joined by another partner, Christy A. Kohl. I am active in the community and current president of the San Diego Chapter of the California Society of Enrolled Agents (CSEA).

**STATEMENT OF GOALS**

The goals of NAEA are my goals insofar as I am involved in any capacity in the organization. Although listed in a different order of priority, the goals of NAEA are almost identical to those of CSEA on whose board of directors I served for four years. As a director, my fiduciary duty and therefore my goal is to promote the pursuit of the strategic plan and the accomplishment of the goals of the organization, without being constrained by the stated desires of my local chapter.

During my interview for the position of NAEA director I was asked to describe myself in one word. My answer was "negative." I am a firm believer in Murphy's Law: "If anything can go wrong, it will." Consequently, I am constantly on the lookout for things/situations that are broken or dysfunctional ... so I can start to fix them. It is how I approach the dreams, hopes and plans that tax clients bring to me ... how can this great idea fail and how can I help prevent that or fix it if it does?

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

For our members and their tax clients, we want to: survive—avoid the pitfalls that can cause 50 percent of new businesses to fail in the first year; grow—if we are not growing, we are falling behind and withering; do good—random acts of kindness are a good source of referrals just as not doing good will get us a bad reputation; do right—instead of wrong within the context of our moral and philosophical compass; do well—so we can afford all of the above.

Our strategic plan goals are all designed to support these principles. At different points in time one goal will take precedence over another. Advocacy has helped us to become legally accepted as enrolled agents throughout the nation, as well as increasingly recognized. In my view Education now must lead. We are an aging population in our membership and we "older and wiser heads" need to help empower the newer members by providing vehicles for our wisdom and knowledge to be distributed.



**CHRIS HARDY, EA**  
NOMINEE FOR DIRECTOR

**BIOGRAPHY**

I am the founder and managing director of Paramount Tax and Accounting, LLC in Oakwood, Georgia. I became an enrolled agent out of a desire to provide more advanced tax advice and guidance to my clients. I have had the privilege of serving at levels from the local chapter to national committees. I feel this gives me enough perspective to appreciate all the hard work that has been accomplished but also benefit from being new enough to the association to bring in outside ideas for advancement from serving on other boards. We are doing many things right, but we need to be more strategic with our planning and activities to increase awareness of enrolled agents and to increase the number of members. I earned my BS in business administration from Lee University in Cleveland, Tennessee. I have also earned the following credentials: enrolled agent, certified financial planner, chartered financial consultant, chartered life underwriter and NTPF Fellow. I have been involved with NAEA by serving on the Bylaws Committee, Public Relations Committee and Membership Committee and have attended the Schuldiner/Smollan Leadership Academy. I have also served as the GAEA president and director and as the Atlanta Chapter president.

**STATEMENT OF GOALS**

I am honored to be nominated for the position of director and have enjoyed being involved at the local, state, and national levels over the past five years. We as an organization must look out five, ten, and twenty years to see what the profession will look like and how the association can align itself best to support its members. This includes better communication to the members on tools and resources available at every stage of business life: startup/growth phase, mid-career/management phase, and succession planning. I would also like to see advancement towards embracing technology that enables us to be more efficient as an association and that provides higher collaboration between the national and affiliate chapters. By strengthening the affiliates, we will strengthen the national association. The new board will be responsible for developing the next strategic plan for NAEA. It is imperative that we build on our recent momentum of having the enrolled agent credential protected with the PATH Act and look to broaden our reach in publicity and membership.

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

The most important strategic goal by far is to increase Member and Affiliate Services. Everything we do revolves around our membership. If price is what you pay and value is what you get, we must continually add more value for our members. We can accomplish this through adding more discounts for member tools, providing turnkey resources to use in our practice and providing more opportunities for members to share best practices.



**JAKE JOHNSTON, EA**  
NOMINEE FOR DIRECTOR

**BIOGRAPHY**

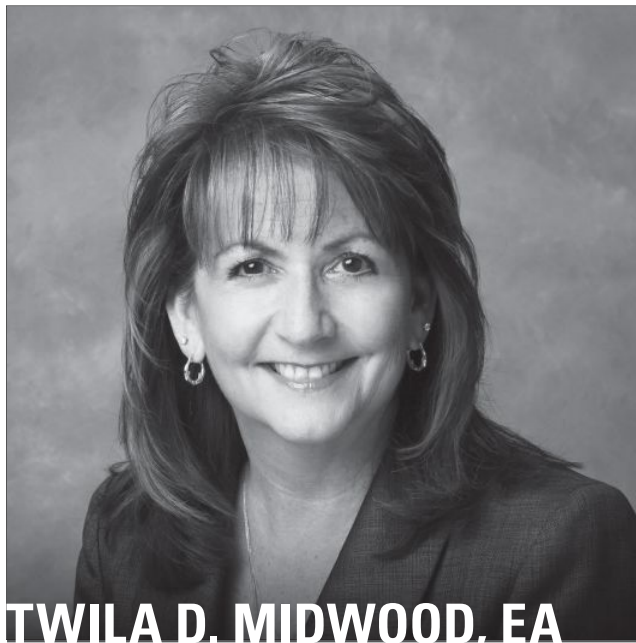
I have been in the tax preparation industry since 1994. I started my own practice in 2002, located in Ogden, Utah. I am an alumnus of Weber State University with a BS in accounting. I hold additional Series 6 and 63 securities licensing along with a life producer license. I am an NTPF Fellow, NTPF Level 2 discussion leader, current member of the NAEA IT Committee, and current president of the Great West Society of Enrolled Agents, an NAEA affiliate. I have extensive experience working on the boards of directors of multiple nonprofit organizations. I am the current treasurer of the Goal Foundation. I was the finance chair of a Blue Ribbon committee for a large colloquial nonprofit organization whose purpose was to bring the organization out of the "red." This was very successful, and the organization is now 40 percent larger due to my efforts. I was the finance chair and on the board of directors with that organization for nine years. I am a supporter of the Educating America initiative with NAEA, and I was responsible for recruiting Weber State University as a new educating organization with SEE classes due to start in May 2017.

**STATEMENT OF GOALS**

My goal is to serve NAEA with a firm contribution of experience and knowledge. I feel that I bring a new perspective of success from my experience at organizations I've previously served. This experience will be coupled with knowledge to form new ideas that will help the organization financially with its growth potential. I feel that we can improve the tangible benefits of the organization, which will give members a concrete financial reason to become members and stay members based upon monetary savings using strategic partnerships. We can then expand the reach of the intangible benefits we provide through our governance relationships that promote our designation as enrolled agents.

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

I believe the promotion of our designation should always be the first and number one goal. I believe we can think outside the box to make "enrolled agents" a household word synonymous with "tax expert." This needs to be done while maintaining an organization that is fiscally responsible to its members.



**TWILA D. MIDWOOD, EA**  
CANDIDATE FOR DIRECTOR

**BIOGRAPHY**

I graduated from Rollins College with a degree in accounting and began my career as a tax preparer in 1995 while working for my father. Upon his retirement, I purchased his practice, obtained my enrolled agent credential in 2003 and immediately joined NAEA. In 2004, I merged my practice with three other principals. Purchasing their shares of stock in 2014, I became the sole owner of Advanced Tax Centre, Inc. I have served NAEA and FSEA in the following capacities: NAEA Affiliate Council chair (2016-2017); FSEA president (2014-2015); FSEA Executive Committee in various positions (2010-2014); FSEA Space Coast Chapter president (2010-2012); NAEA Schuldiner/Smollan Leadership Academy graduate (2011); NAEA NTPI Fellow (2007); on numerous committees at both the national and state levels (2010-2017).

**STATEMENT OF GOALS**

The most important challenge facing our organization right now is growth and retention of members. We must focus our attention on this issue by providing value in joining our organization. One of the key benefits of membership would be to provide more educational webinars. Our organization has many talented, well-qualified speakers who could provide outstanding webinars. We have members who do not have the resources to travel to NAEA events and who receive their education from webinars provided by other organizations. We must tap into that market.

Also, we must reach out and recognize new members at NAEA events. We should encourage them to become involved, let them know they add value to our organization and that NAEA has many benefits to offer them. This could be accomplished through the collaboration of the Membership Committee and NAEA. Additionally, members want to know what is happening within their organization and how their dues are spent. It is critical that NAEA staff, the board and Affiliate Council work closely with affiliate leaders so that some of this information can be disseminated among our members.

We need to return NAEA to a member organization so that we can grow stronger and have a louder voice when advocating for our credential. Together, we are the tEAm!

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

I would support Member and Affiliate Services. We are facing a serious decline in membership. We are the only association that advocates for enrolled agents, separating us from other professional organizations. Without a strong membership, we lack the strength and voices to be successful advocates for our enrolled agent credential!



**JOYCE MOHR, EA**  
NOMINEE FOR DIRECTOR

**BIOGRAPHY**

I became an enrolled agent and member of NAEA in 2007. My business, Taxes Plus, is a tax preparation, consulting and representation business serving clients with a wide range of tax needs (2011-present), with locations in Somerville, Massachusetts, and Rockport, Maine.

I am very grateful to have had the opportunity to serve at the national and affiliate levels. My NNESEA involvement includes: Schuldiner/Smollan Leadership Academy Advisory Board (2015-2016); Governance Committee (2016); Nominating Committee (2012-2013); Government Relations Committee (2014); Governance Structure Task Force (2014); Government Relations Fly-In participant (fifth time in 2016), NTPI Fellow (2014); Schuldiner/Smollan Leadership Academy graduate (MA pilot and 2013 Orlando, FL). For MaSEA, my involvement includes: immediate past president (2015-present); president (2013-2014); first vice president (2009-2013); EA of the Year Award (2013); SEE Preparation Course instructor (2009-present).

**STATEMENT OF GOALS**

I am honored and excited to be nominated again for an NAEA director position. Serving on the NAEA Board has been interesting and rewarding. If re-elected as director, I will have the opportunity to participate in the strategic planning process. This is critical for our organization. I have been fortunate to have a wide variety of experiences in NAEA. I think this uniquely positions me to be a valuable asset in this process. I am very hopeful that I will be afforded the opportunity to participate in this important work.

Through the Schuldiner/Smollan Leadership Academy, APEX, Affiliate Council, Educating America and other programs at NAEA, we will continue to offer members opportunities to grow in leadership, grow in our organization and grow in their careers.

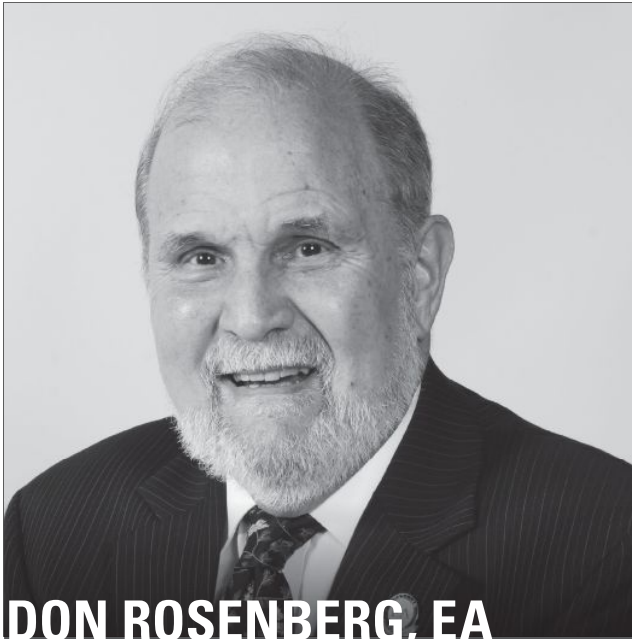
**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

I fully support the NAEA 2012-2015 Strategic Plan goals of Awareness, Advocacy, Education, Member and Affiliate Services, Organization/Infrastructure, and Financial Security.

Thank you for your consideration. I would love the opportunity to continue to represent NAEA members and to work to ensure that enrolled agents are widely known as America's tax experts.

It is important to focus on all of our goals. Each goal supports the others in a variety of ways. Ignoring or failing at one would leave our organization much less successful.

Member and Affiliate Services is the strategic goal I would choose as currently the most important.



**DON ROSENBERG, EA**  
NOMINEE FOR DIRECTOR

**BIOGRAPHY**

I am completing my first term as a director of NAEA, and I look forward to your support for a second term. Needless to say, this current board has had to struggle with very difficult times. I believe that we rose to the occasion selecting Cedric as our executive vice president and putting in place mechanisms to recover from our financial crisis and to make sure that there are ongoing controls to prevent this from happening again. This new board will be developing our next strategic plan. I have worked on strategic planning for several membership organizations and am trained in SWOT analysis.

I have been an enrolled agent for over 20 years. My practice includes business and individual tax returns, business write-up, and taxpayer representation. I am an adjunct lecturer at CUNY's Hostos Community College in the Bronx.

I have served NAEA as an NTPI Level 2 instructor for 10 years, and I have trained many NTPI Fellows. I chair the Schuldiner/Smollan Leadership Academy Advisory Board and have just completed my second term as president of NYSSEA. I am a Leadership Academy graduate, an NTPI Fellow, former chair of the NTPI Planning Committee, and I have served as a consultant to the Educating America Implementation Task Force and as a member of the Tax Prep Committee.

**STATEMENT OF GOALS**

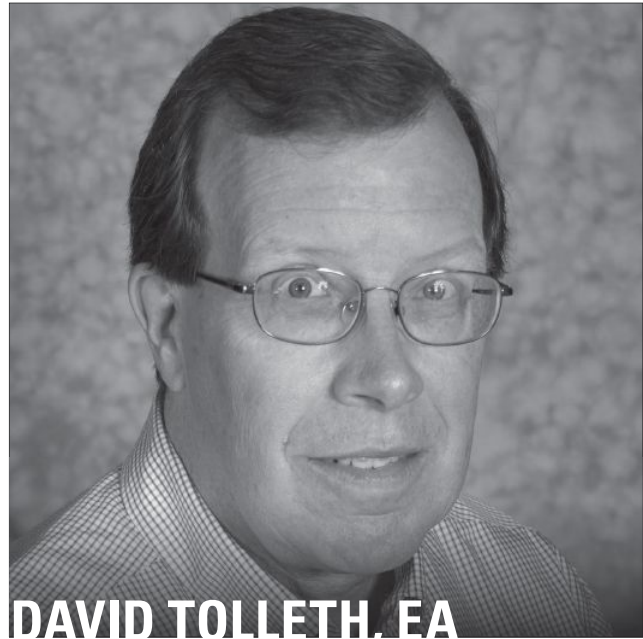
Promoting the value of membership to current members and non-member EAs is my number one goal. My experience at the community college level enables me to bring insight to the board to help further our Educating America initiative to bring in new members.

Without the right to practice, all our goals would be meaningless; we would not have a credential to be recognized. I support and will work with the Government Relations team to help the IRS develop meaningful regulation of the tax preparation industry.

My goals for education are simple: continue to offer premier programs like NTPI. We should develop a representation course for our affiliates, providing members local representation training. In addition, we need to strengthen our tax prep courses; this year I served under the leadership of Bill Nemeth, EA, and we had a strong program at our National Conference.

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

We must enhance membership by providing value to our members and to EAs. More members ensure financial stability and strengthen our programs. We must expand by penetrating the EA market, but we must never lose focus on our mission to serve the EA community exclusively. That is our competitive advantage.



**DAVID TOLLETH, EA**  
CANDIDATE FOR DIRECTOR

**BIOGRAPHY**

Before I became an EA, I spent 25 years in the technology industry, holding executive positions in large and small firms. I have been a consultant to Fortune 500 firms and sole proprietorships, typically advising leaders on how to maximize the potential of their people and their financial resources. I hold a Ph.D. in Physics.

I earned my EA license in August 2008 and immediately joined NAEA. I started attending New Jersey Society of Enrolled Agents meetings, studied representation, became an NTPI Fellow (2011), and attended the NAEA Schuldiner/Smollan Leadership Academy (2012). I served on the NAEA Bylaws Committee (2013–2016), Nominating Committee (2015–2016), and Membership Committee (2016–2017).

During my leadership tenure (2012–2016), we have rebuilt my state affiliate from the ground up. We have grown membership 10 percent, more than doubled the number of educational events we offer annually, and increased member participation 400 percent. We now have a highly engaged board serving our members. I have served as secretary (2012–2013), vice president (2013–2014), and president (2014–2016). I am currently immediate past president and Education Committee chair.

I believe my varied business experiences, past NAEA experience and training, and a seasoned ability to listen carefully and build consensus among groups with varied perspectives uniquely qualify me to serve as your NAEA board director.

**STATEMENT OF GOALS**

Fellow EAs and clients continually remind me that most of the general public does not recognize the EA credential. NAEA does a great job with the resources it has to promote EAs with the federal government and through its many PR efforts, but it's an uphill battle when NAEA counts less than 20 percent of EAs among its membership.

As a director, I will continue to work hard to engage and bring more of the EA community into our association and attract more tax professionals into the EA profession. I will develop tools for NAEA affiliates to offer best-in-class EA exam preparation courses, create a speaker bureau to expand and deliver NAEA tax training regionally, and build programs to attract the over 60,000 AFSP participants and the other 80 percent of EAs who are not yet members.

**NAEA'S MOST IMPORTANT STRATEGIC GOAL**

I believe the primary objective of NAEA's Member and Affiliate Services strategic goal should be to grow the NAEA membership. Member dues control the budget available for everything NAEA does to serve its members—advocacy, recognition of EAs and education. More members = more services = more members.



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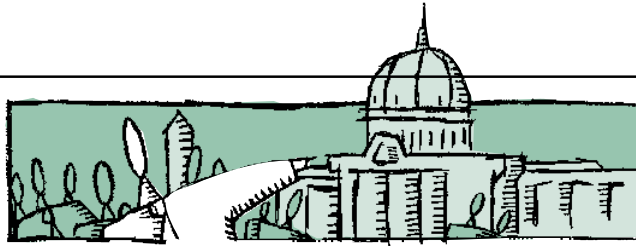
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CAPITOL CORNER

# Bad Company Ruins Good Morals

By Robert Kerr

**A**s 2016 draws to a close, I'm going to wrap up with a laundry list of items that trouble me (and I'll omit my thinning hair and expanding waistline—though those also trouble me): security; user fees; Circular 230; and, unavoidably, the election.

Let's take these one at a time.

While the Magic 8 Ball has been in the shop for more months than I can count, I'm going out on a limb to prognosticate that the most significant EA issue of the upcoming filing season will not be the delayed refunds for EITC and ACTC taxpayers (courtesy of the December 2015 PATH Act, which also brought us the EA Credential Act, which allows EAs to hold themselves forth as EAs in every state of the union, brought to you courtesy of the only association lobbying on behalf

of enrolled agents—NAEA). The most significant issue of the upcoming filing season also will not be related to late tax law changes, as there are only a few extenders of significance still in play. The most significant issue of the coming filing season for EAs (and probably non-EAs) will be ... drum roll, please ... SIRF.

SIRF?

Ah, yes. Another acronym brought to you by 1111 Constitution. SIRF is the acronym for stolen identity refund fraud. The top-of-mind issue for

EAs—and their clients—is going to be identity theft. Fraudsters are out in force. Calling. Texting. The latest we've heard at NAEA is they're Skyping, too. So don't ever hold up your credit card to a Skype screen—and I'm not kidding, we've heard of this one.

IRS is seriously concerned. You should be, too.

As you prepare for the filing season, please consider the exposure your clients have to fraudsters. Please also consider your professional exposure. I suspect the majority of you have had conversations with your clients and have included tips on avoiding fraudsters in general within newsletters (by the way, Federal Trade Commission at [www.ftc.gov](http://www.ftc.gov) has a number of nice tips designed for the general public). Enrolled agents are tax experts of course, but EAs also provide soup-to-nuts tax service—tax planning, tax prep, and tax representation—and clients often look to their tax guy or gal for more general advice.

That's well and good, but the fact of the matter is that tax professionals of

## 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.

all stripes have become fraud targets. Why? The old Billy Sutton story, that's why. You'll recall he was a notorious bank robber and when asked why he robbed banks, he famously replied, "That's where they keep all the money."

Well, as it turns out, tax fraudsters are looking for personally identifiable information (PII) and as it turns out, tax pros possess a ton of PII. Now we write often on the issue in *E@lert*, simply to raise awareness, but as a matter of course we want to emphasize the issue here.

The latest tax pro scheme is a phishing e-mail scam that appears to be from a tax software provider and attempts to trick the recipient into clicking on a bogus link that purportedly installs an important software update. The link does not download a software update; it downloads a program that tracks keystrokes, which in turn allows thieves to steal sensitive data (SSNs, names, login information, and so forth).

We need to take this threat seriously. The thieves are getting more and more sophisticated. IRS provides advice on its website, as well as in Publication 4557 (Safeguarding Taxpayer Data). Take appropriate steps to protect your electronic data and to secure your sensitive documents. As I've suggested in other contexts, it's a dog-eat-dog world out there, and they're short on napkins.

\*\*\*\*\*

Shifting gears a bit, I'm also fired up about IRS user fees, both the user fees IRS acknowledges and those it does not.

NAEA has been fighting proposed SEE user fee increases. You know that, or should know that. In January, IRS

issued proposed regulations that would increase ninefold the fee it charges to oversee the exam (the new fee would be \$99 per part while the previous fee was \$11). The administrative user fee would be higher than the fee the private sector firm that designs and administers the examinations charges prospective EAs to take the exam.

In late August, IRS issued proposed new user fees for installment agreements. We covered this in detail in *E@lert*, but the net is that the new structure would include several more tiers. Some fees would increase (in-person, non-direct debit), while some would decrease (online, direct debit).

In early September the agency also announced it had awarded a new continuing education vendor contract and that the annual fee to CE providers would be \$419. What it didn't state was that the new fee was 35 percent higher than it had been in prior years. When we reached out to the Return Preparer Office, we learned *au contraire*, the fee is not a user fee. Nope. IRS entered into a no-cost (to the government) contract (to be fair, the prior contract was the same type) and that the \$419 went entirely to the vendor.

And I shouldn't leak this information, but I have heard from an unimpeachable (and no, I'm not being cute about the commissioner's impeachment near-miss) source that the Service has in the works an enormous hike to the OIC user fee. I won't breathe the number, but let's just say it has a comma in it.

The common question in my humble opinion is why. Why does IRS insist

on charging user fees? In the case of the SEE and installment agreements, it insists it is required by OMB Circular A-25 to do so.

We disagree. As our then-president, Terry Durkin, EA, wrote Commissioner Koskinen in February:

OMB Circular A-25 clearly states: No charge should be made for a service when the identification of the specific beneficiary is obscure, and the service can be considered primarily as benefiting broadly the general public.

We aren't suggesting that tax administration doesn't benefit from enrolled agents. To the contrary, we believe it does, and handsomely. But who is the beneficiary? The prospective enrolled agent? Clients of the prospective enrolled agent? The tax administration system? The general public? Clearly, all of these groups benefit from the existence of federally licensed tax practitioners who are tested and required to complete annual continuing education specifically on tax.

We will continue to fight this fight.

\*\*\*\*\*

I have included Circular 230 in the list not because it is in and of itself troubling. It isn't. At the risk of overstepping here, it seems to me that we all at least pay lip service to the importance of Circular 230, and we all understand it is the foundational document for enrolled agents. If enrolled agents were a religion, it would be our Ten Commandments.

But...

In our "religion," many of us don't revisit Circular 230 as often as we should.



The interesting thing about the document is that I learn something new every time I consult it. Even more interesting, I'm told—now this is secondhand, so don't hold me to it—that no less an authority than former Office of Professional Responsibility Director Karen Hawkins allowed she learned something each time she read Circular 230.

Long story short: Pick up Circular 230 and read it. The document is not

lengthy. And no, you don't already *know* everything in it. I promise.

\*\*\*\*\*

Speaking of religion—and my apologies if anyone is troubled by this—I was reminded of a passage from my parochial school days: “Bad company ruins good morals.” I'd like this article to be a gentle reminder that enrolled agents play an important role: as pillars of the tax professional community, as

invaluable partners to their clients, as defenders of taxpayers and partners in tax administration.

Some bad company is obvious. And we obviously should avoid it at all costs. Some bad company, however, is not so obvious, such as decisions that erode tax administration or our own complacency. And we should avoid the not-so-obvious bad company at all costs, as well. **EA**

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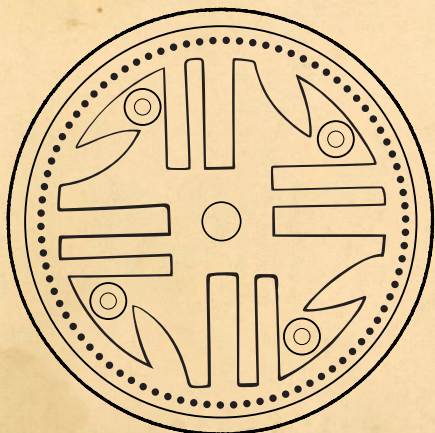
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- 2 We help invite your clients to "Follow" you.
- 3 We post relevant tax tips on your behalf.
- 4 As people "Like" and "Share" your tips, they promote your practice to their own friends and family.

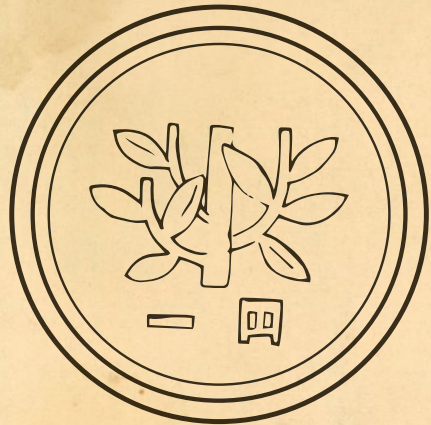


# UNDERSTANDING THE PFIC RULES

*and the Implications of Owning Foreign Mutual Funds*

Michael J. DeBlis III, Esq. and Randall Brody, EA





**W**hile many portions of the U.S. tax code possess confusing and sometimes harsh rulings, the tax rules for passive foreign investment companies (PFICs) are almost unmatched in their complexity and draconian features. Countless times, Americans overseas uncover a startling revelation that the small foreign investment they had made in a non-U.S. mutual fund is now subjecting them to all the significant filing requirements and tax obligations that apply to a PFIC.

The tax laws involving PFICs are extremely complex and not very well known by the majority of investors and tax professionals. While it is beyond the scope of this article to cover all the numerous details related to PFIC reporting requirements, our hope is to provide guidance and awareness into the world of PFICs so that U.S. taxpayers can be advised of the consequences by their U.S. tax professional.

#### What Is a PFIC?

There are two central elements that form the basis of PFIC taxation: the definition of a PFIC and the tax treatment imposed on U.S. shareholders.

A PFIC is generally defined as an entity that receives mainly passive investment income or holds mainly passive investment assets. Specifically, a

foreign corporation is defined as a PFIC if it meets either of the following tests that apply to passive income:

- Income Test: 75 percent or more of the corporation's gross income is passive income (interest, dividends, capital gains, rents, etc.),<sup>1</sup> or
- Asset Test: 50 percent or more of the corporation's total assets are passive assets. Passive assets include cash and any investments that produce passive income (such as interest, dividends, rents and/or capital gains).<sup>2</sup>

PFICs often include foreign-based mutual funds, exchange-traded funds (ETFs), money market accounts, and other pooled investment vehicles such as many foreign real estate investment trusts that have at least one U.S. shareholder.



## UNDERSTANDING THE PFIC RULES

*and the Implications of Owning  
Foreign Mutual Funds*

Finally, a foreign holding company that possesses passive investments, like rental real estate or government bonds, would be subject to PFIC regulations if the company is set up as a foreign corporation (based on the U.S. code definition of a foreign corporation).

PFICs are subject to complicated and strict tax guidelines, which cover treatment of these investments in Sections 1291–1297 of the Internal Revenue Code. Both the PFIC and the shareholder must keep accurate

that derived only foreign-source income. The fund was able to avoid the taint of being classified as a controlled foreign corporation because it was owned by a large number of U.S. and foreign investors, each of whom owned a relatively small percentage.

The enactment in 1986 of the Tax Reform Act changed all that. For starters, it significantly expanded the reach of U.S. taxing authorities with respect to passive investment income earned by U.S. persons through foreign corporations. An important feature of

is designed to eliminate the benefits of deferral. However, each differs in the way it accomplishes this objective.

The specifics depend on whether the shareholders of the PFIC have made an election such as an “election to mark-to-market (MTM) PFIC stock,” “election to treat the PFIC as a qualified electing fund (QEF),” or whether the “default” PFIC tax regime of Sec. 1291 applies.

### Qualified Election Fund

The QEF is designed to reduce the complex default treatment of PFIC taxation. The QEF election puts U.S. shareholders in a position almost the same as if they had invested in a domestic mutual fund. It accomplishes this by allowing shareholders the opportunity to elect to be taxed currently on their pro rata share of the PFIC’s earnings and profits. The included income is treated as ordinary income to the extent of the taxpayer’s pro rata share of the QEF’s ordinary income, and capital gains to the extent of the taxpayer’s *pro rata* share of the QEF’s net capital gain.

However, to make this election, shareholders must receive a PFIC Annual Information Statement every year the election is in effect.<sup>3</sup> An authorized representative of the PFIC must sign it.<sup>4</sup> For foreign mutual funds that are PFICs, this is not a very common election to qualify for, as very few foreign mutual fund companies are willing to issue the Annual Information Statement to shareholders as required.

A QEF election must generally be made during the first year of ownership no later than the due date (including extensions) of the tax return. While you cannot make a late or retroactive QEF election, it is possible to make a QEF election for the current year and future years. Making what is known as a

## *The taxation of PFICs is built on the idea of removing the benefit of U.S. tax deferral on all passive investments by foreign entities.*

records of all transactions, including share basis, dividends and any undistributed income earned by the company in order to complete all required reporting.

### PFIC History

The PFIC tax regime was created via the Tax Reform Act of 1986 with the intent to level the playing field for U.S.-based investments such as mutual funds. Prior to the legislation of 1986, U.S.-based mutual funds were forced to pass through all investment income earned by the fund to its investors, resulting in taxable income.

U.S. taxation of foreign corporations was strictly tied to control of the corporation held by U.S. persons. This allowed not only foreign mutual funds to avoid U.S. taxation but also U.S. persons who invested in them. For starters, the fund itself avoided U.S. taxation, because it was a foreign corporation

PFIC taxation is that it applies without regard to the extent of U.S. ownership.

The taxation of PFICs is built on the idea of removing the benefit of U.S. tax deferral on all passive investments by foreign entities. The rules achieve this end in one of two ways: first, by directly taxing U.S. investors in PFICs, and second, by imposing an interest charge on these investments on deferred distributions and dispositions (gains).

After the passage of the Tax Reform Act of 1986, the main advantage of foreign mutual funds was effectively nullified by a tax regime that made the practice of delaying the distribution of income prohibitively expensive for most investors.

To employ this punitive regime, the IRS requires shareholders of PFICs to effectively report undistributed earnings via choosing to be taxed through one of three possible methods. Each method



purging election, which is in essence making a pretend sale of the PFIC under the excess distribution regime, a QEF election can be made prospectively.

### Mark to Market

To make an MTM election, the PFIC must be marketable stock that is regularly traded on a national exchange registered with the U.S. Securities and Exchange Commission or other exchange or market that meets IRS qualifications.<sup>5</sup>

With this election at the end of each year, MTM gains are calculated as if there was a disposition of the PFIC stock on the last day of the tax year. The MTM gain is taxed at the ordinary income tax rate and the basis of the PFIC stock is increased by the MTM gain included in income.

Most foreign mutual fund holdings will qualify for an MTM election if the election is timely made. To be timely made, an MTM election must be made during the first year of ownership no later than the due date (including extensions) of the tax return.

However, the problem is that a timely election is often not made, as the taxpayer is not even aware that he or she has a PFIC holding. While there is no option to make a late or retroactive election, you can make an MTM election prospectively by having a “pretend” sale of the PFIC holding under the excess distribution rules as of the last day of the tax year. Then, in the following year, the MTM rules will apply.

### Default Rules

A taxpayer who does not make an election is taxed under the default PFIC tax regime of Sec. 1291. Under this regime, taxpayers are permitted to defer taxation of a PFIC’s undistributed income until the PFIC makes

an excess distribution. An excess distribution includes the following:

- a disposition (*i.e.* sale) gain realized on the sale of PFIC stock
- any actual distribution made by the PFIC, but only to the extent that the total actual distributions received for the year exceed 125 percent of the average actual distribution received in the preceding three taxable years (or, if shorter, the taxpayer’s holding period before the current taxable year)

Sec. 1291 is designed to eliminate and penalize the tax benefit of deferral on PFIC investments. Taking a big-picture view makes it easier to understand how PFIC taxation undoes this advantage. First, the economic value of deferral of U.S. taxation is the *time value* of the deferral itself. And second, PFIC taxation takes back the time value of deferral through the deferred tax amount.

Critical to understanding how PFIC taxation takes back the time value of deferral through the deferred tax amount is the treatment of excess distributions. An excess distribution is treated as if it has been realized *pro rata* over the holding period for the PFIC’s stock.

With that in mind, the effect of a *pro rata* realization of an excess distribution becomes painfully obvious: The tax due on such a distribution is the sum of deferred yearly tax amounts plus interest. But the worst is yet to come. And that is that the deferred yearly tax amounts are calculated using the *highest tax rate* in effect in the years that the income was accumulated.

Very simply, this method unilaterally eviscerates the benefits of deferral by assessing an interest charge on the deferred yearly tax amounts. While there is no silver lining, taxpayers can take some comfort in the

fact that they can claim a direct foreign tax credit for any withholding taxes imposed on PFIC distributions and dispositions.

To calculate the “excess distribution” for a sale (called a disposition), first the gain must be calculated and then the excess distribution (gain) is allocated to each day in the holding period and separated between the current tax year and prior years. The portion allocated to the current tax year is taxed as ordinary income at the ordinary income tax rate applicable to the taxpayer during the current tax year.

Tax is then calculated on the allocated excess distribution applicable to the prior years based on the highest ordinary income tax rate in effect for the tax year to which it was allocated. Current-year tax is then increased by this deferred tax with interest as if the deferred tax were an underpayment for the prior years in which this excess distribution is attributed.

The purpose is to in effect change the recognition of income and impose an interest charge based on deemed tax underpayments for prior years.

The taxpayer does not recognize a loss realized on a Sec. 1291 disposition. However, there are proposed regulations that may change this current treatment at some point in the future, but such proposals have been circulating for years.

An example will help illustrate how Sec. 1291 operates.

Fred is a U.S. citizen who invests in mutual funds. On the advice of his broker in the United Kingdom, on January 1, 2013, he buys 1,200 shares of FORMut for USD \$2,400, a mutual fund incorporated in the United Kingdom. Because FORMut only earns passive income on passive assets, it is a PFIC.

Not having any knowledge of international tax or the PFIC rules, Fred and his



## UNDERSTANDING THE PFIC RULES

*and the Implications of Owning  
Foreign Mutual Funds*

tax preparer fail to make any election. On December 31, 2015, Fred sells (disposes of) all 1,200 of his FORMut shares upon learning of the punitive tax treatment of PFICs for total proceeds of USD \$5,400.

Because Fred never made any election, Fred must “throw back” the entire USD \$3,000 gain received over the entire period that he owned the FORMut shares: \$1,000 to 2013, \$1,000 to 2014, and \$1,000 to 2015. For each of these years, Fred will pay tax on the thrown-back gain at the highest ordinary income tax rate in effect that year with interest.

### Form 8621 Filing Requirements

As far as filing requirements go, a U.S. person must file for each PFIC owned on Form 8621 (Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund) if the U.S. taxpayer:

- received direct or indirect distributions (i.e. dividends) from a PFIC
- recognizes gain on a direct or indirect disposition (i.e. a sale) of PFIC stock
- is reporting information with respect to a QEF or MTM election
- is making an election such as a QEF or MTM election
- the aggregate value of the U.S. person’s PFIC stock is more than \$25,000 and is required to file an annual report

Adding to the complexity and volume of paperwork is that a separate Form 8621 must be filed for each PFIC (i.e. each separate mutual fund) owned.

Form 8621 is attached to the shareholder’s tax return and both must be filed by the due date, including extensions, of the return at the Internal Revenue Service Center where the tax return is required to be filed.

### Consequences for Failing to File Form 8621

Sec. 1298(f) and the regulations do not impose a specific penalty for failing to file Form 8621. However, failure to file a required Form 8621 can result in suspension of the statute of limitations with respect to the shareholder’s entire tax return until the Form 8621 is filed. This means that the IRS could potentially have an unlimited amount of time to audit a U.S. shareholder’s

tax return and assess tax if the shareholder fails to file a required Form 8621. However, this comes with an important caveat. To the extent that the shareholder has reasonable cause for failing to file Form 8621 (i.e., a defense), the statute of limitations can be suspended only with respect to unreported PFIC investments and not to any unrelated portions of the individual tax return.

It is also important to note that under Sec. 6038D, a U.S. individual must disclose any directly held specified foreign financial assets

on Form 8938 (Statement of Specified Foreign Financial Assets) if the aggregate value of the individual’s specified foreign financial assets exceeds the filing requirement threshold. A U.S. taxpayer who fails to disclose a directly held PFIC investment on either Form 8621 or Form 8938 can be subject to a \$10,000 penalty under Sec. 6038D(d).

### Foreign Mutual Fund Pitfalls

As one can imagine, many U.S. taxpayers abroad invest in foreign mutual funds not knowing the PFIC rules, unaware of the pitfalls of such investments. Taxpayers should be advised by their U.S. tax professional to pay particular attention to investments in foreign mutual funds and other investments that could be deemed to be a PFIC, particularly when investing through foreign banks and brokerages.

Before making a foreign investment, taxpayers should proceed with caution and be aware of the punitive tax consequences and significant costs of compliance of investing in foreign mutual funds. **EA**

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1. IRC Sec. 1297(a)
2. IRC Sec. 1297(a)
3. Sec. 1.1295-1(f)(2)(C)
4. Sec. 1.1295-1(g)(1)
5. Sec. 1.1296(e)



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NAEA 2016 Tax Update Webinars are being finalized and will feature everything you need to know to be ready for the upcoming filing season. Stay tuned for updates in *E@lert* and on social media!

*"I went back to the office and paid for these classes with a single job."*

— NTPI Level 1 attendee



# SECTION 174

## RESEARCH AND DEVELOPMENT CREDIT REVISED REGULATION ANALYSIS

By Darshan Wadhwa, CPA, Luis Patrída, Javier Leon,  
And Vinh-Huy & John Leavins, CPA

In 1954, Congress enacted a temporary research and development (R&D) credit codified by Internal Revenue Code (IRC) Sec. 174. The purpose of the credit is to encourage inventors and companies to pursue research and development of new technologies. Although simple in theory, there have been problems with its implementation. Critics have argued that the credit is confusing as to which expenses qualify as “qualified research expenses.”<sup>21</sup> In an effort to clarify taxpayer questions, the IRS finalized Treasury Decision (TD) 9680 in 2014 to provide clearer definitions and additional examples to assist taxpayers with taking the R&D credit. This article will explore IRC Sec. 174, summarize the revised regulations set forth in TD 9680, and explain some of the new examples added to the treasury regulation.



Research and experimentation expenditures is defined by Sec. 174 as the “expenditures incurred in connection with the taxpayer’s trade or business which represents research and development costs in the experimental or laboratory sense.”<sup>2</sup> This definition encompasses all costs that are incurred in the development or improvement of a product.

In addition, these expenditures include the costs of obtaining a patent. An example of a patent cost would be the attorney’s fees incurred in making a patent application.

Lastly, these costs qualify as R&D costs if they are expended for activities meant to discover information that would eliminate uncertainty related to the development or improvement of a product.<sup>3</sup>

This uncertainty can exist if the information available to the taxpayer does not establish the capability or process for developing or improving the product or the appropriate design of the product. The deciding factor as to whether the expenditure qualifies as a research and experimentation expenditure depends

on the nature of the activity the expenditures relate to. It does not depend on the nature of the product being developed or the level of technological advancement the improvement represents. The success or failure of the final product is not relevant to the determination of eligibility under Sec. 174. Costs that are eligible are those paid or incurred after production begins but before uncertainty concerning the development or improvement of the product is eliminated.<sup>4</sup>

The term “product” includes any “pilot model, process, formula, invention,

technique, patent, or similar property, including products to be used by the taxpayer in its trade of business, as well as products to be held for sale, lease, or license.”<sup>5</sup> Pilot models to be expended must be a representation of a product that is created to evaluate and manage risk concerning the product during the development or improvement of the product. This definition of a pilot model includes a fully functional model of the product.<sup>6</sup>

Some research and experimentation expenditures that are excluded include:

- the ordinary testing or inspection of materials or products for quality control
- efficiency surveys
- management studies
- consumer surveys
- advertising or promotion expenses
- acquisitions of other patents, models, or processes
- research in connection with literary, historical, or similar projects

Due to the nature of business deductions, research and experimentation expenses are limited to reasonable amounts.

Sec. 174 applies to a research and experimentation expense only to the extent that the amount is reasonable under the circumstances. A general rule is that the amount of an expenditure is reasonable if the amount would ordinarily be paid for similar activities by similar enterprises under similar circumstances.

There are certain amounts that are supposedly paid for research that are not reasonable under the circumstances

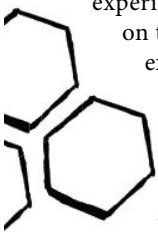
that may be characterized as disguised dividends, gifts, loans, or payments of the sort. The reasonableness requirement does not apply to the reasonableness of the type or nature of the activities themselves but of only the amounts.<sup>7</sup>

Sec. 174 also allows the deduction of money paid to others for research and experimentation. This section applies to expenditures paid for research and experimentation carried out on the taxpayer’s behalf by another person or enterprise. An enterprise can be a research institute, foundation, engineering company, or another similar contractor.<sup>8</sup>

There are also certain expenditures with respect to land, depreciable property, and exploration included in Sec.

174. Expenditures made by the taxpayer to acquire or improve land or any property which is subject to an allowance for depreciation or depletion are not deductible under Sec. 174 regardless of whether the property is used by the taxpayer in connection with research and experimentation. However, allowances for

depreciation or depletion of property are considered as research and experimentation expenditures to the extent that the property



# SECTION 174

## RESEARCH AND DEVELOPMENT CREDIT REVISED REGULATION ANALYSIS



the allowances relate to is used in connection with research and experimentation.

Another allowance under Sec. 174 are amounts paid to others for research and experimentation resulting in depreciable property. If research and experimentation expenditures are incurred in connection with the construction or manufacture of depreciable property by another, these expenditures are deductible under Sec. 174 only if made upon the taxpayer's order and at his or her risk.<sup>9</sup>

### Proposed Revisions

After soliciting comments from taxpayers, the IRS and the Treasury Department released TD 9680, which summarized the proposed regulations and laid out the final language for Treasury Regulation Sec. 1.174-2. The proposed revisions to the then current regulations are as follows:

- 1) To counter an interpretation that Sec. 174 eligibility can be reversed by a subsequent event, the proposed regulations provided that the ultimate success, failure, sale, or other use of

- 2) The proposed regulations amended Sec. 1.174-2(b)(4) to prove the Depreciable Property Rule (the rules in Sec. 1.174-2(b)(1) and Sec. 1.174-2(b)(4)) is an application of the general definition of research or experimental expenditures provided for in Sec. 1.174-2(a)(a) and should not be applied to exclude otherwise eligible expenditures.
- 3) The proposed regulations defined the term "pilot model" as any representation or model of a product that is produced to evaluate and resolve uncertainty concerning the product during the development or improvement of the product. The term included a fully functional representation or model of the product or a component of a product (to the extent the Shrinking-Back Rule applies).
- 4) The proposed regulations clarified the general rule that the costs of producing a product after uncertainty concerning the development or improvement of a product is eliminated are not eligible

the rule provided in Sec. 1.41-4(b)(2), to address situations in which the requirements of Sec. 1.174-2(a)(1) are met with respect to only a component part of a larger product and are not met with respect to the overall product itself.

These proposed changes gave way for enhanced definitions and numerous examples to assist taxpayers in determining which expenses qualify as R&D expenses. Treasury Regulation Sec. 1.174-2(a)(1) prior to the revision defined allowable R&D expenditures to include those that:

- are incurred in connection with a trade or business
- represent R&D costs in the experimental or laboratory sense
- represent costs in the experimental or laboratory sense if they are incurred with the intent to discover information that would eliminate uncertainty concerning the development or improvement of a product<sup>10</sup>

The final regulation clarifies what products qualify under Sec. 174. It states that future use, sale, or failure of the product does not affect its eligibility.<sup>11</sup> This is an important clarification for taxpayers, because it removes the uncertainty of a qualifying purchase if the product is not successful.

### Definition of Pilot Model

Finally, there has always been a question as to what defines a pilot model under Treas. Reg. Sec. 1.174-2(a)(3). The final regulation adds that a pilot model is "any representation or model of a product that is produced to evaluate and resolve uncertainty concerning the product during the development or improvement of the product."<sup>12</sup> As stated previously, the term includes a fully functional representation

**The final regulation clarifies what products qualify under Sec. 174. It states that future use, sale, or failure of the product does not affect its eligibility.**

the research or property resulting from research or experimentation is not relevant to a determination of eligibility under Sec. 174.

under Sec. 174 because these costs are not for research or experimentation.

- 5) The proposed regulations provided a shrinking-back rule, similar to



or model of the product or a component of the product.<sup>13</sup>

### New Examples under Sec. 174

The 10 new examples in the Sec. 174 amendments help clarify the irrelevance of depreciable property produced from qualifying activities. They also emphasize that only expenditures representing research and experimental development costs qualify for treatment under Sec. 174. These examples help manufacturers of both custom and mass produced products, because the ultimate use or disposal of any pilot model produced is not relevant. Further, the term can refer to either a fully functional representation or model of the product or a component of the product.<sup>14</sup>

The examples presented in Sec. 1.174-2(a) emphasize the treatment of pilot models, the final product, and component parts. The cost of producing the final product will not qualify after the uncertainty has been eliminated. However, the costs of producing pilot models and the costs of testing pilot models do qualify for Sec. 174 deductions. Similarly, for the components of the products, the cost to retest and reconfigure a failed component design of a produced machine found during quality control testing also qualifies.

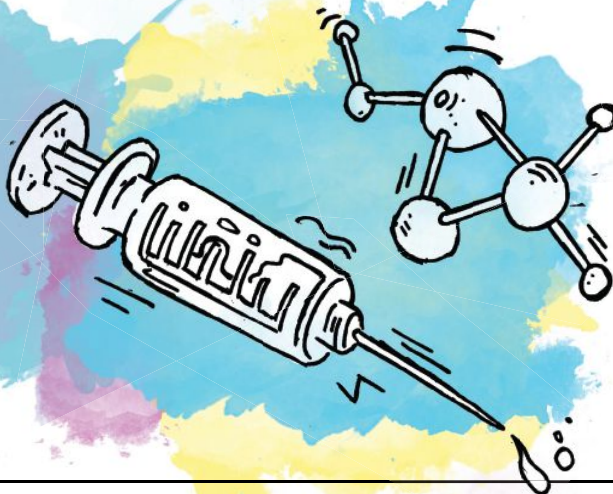
A component produced to test and eliminate uncertainties is also considered a pilot model, but the cost to produce the redesigned component does not qualify because the uncertainty has already been eliminated.

The costs to produce multiple pilot models also qualify, as long as they were produced to eliminate uncertainty. They are defined as pilot models, and their subsequent sale or destruction has no effect on the qualification of their production cost. The examples further illustrate that the cost to produce and test redesigns and new components of equipment, as well as the research and development of new production processes, qualify for Sec. 174 treatment.<sup>15</sup>

The examples presented in Sec. 1.174-2(b) broaden contracted research and development costs and the application of the Depreciable Property Rule. In example 1 of paragraph B, a company is contracted with no guarantee of economic utility to provide a specially built machine. The production cost of the contract does not qualify, and the qualification of the contract cost is limited to the extent that the amounts expended were used by the contractor for research or experimentation.

In example 10 paragraph 3, it states: No deduction will be allowed (i) if the taxpayer purchases another's product under a performance guarantee (whether express, implied, or imposed by local law) unless the guarantee is limited to engineering specifications or otherwise, in such a way that economic utility is not taken into account; or (ii) for any part of the purchase price of a product in regular production.

The last two examples clarify the application of the Depreciable Property Rule. In the second example, \$5,000,000 is spent by an aircraft manufacturer to construct a new test bed to develop and improve manufactured aircrafts. None of the \$5,000,000 can be deducted, because it does not meet the definition of R&D costs.<sup>16</sup> "Expenditures by the taxpayer for the acquisition or improvement of land, or for the acquisition or improvement of property which is subject to an allowance for depreciation under Sec. 167 or depletion under Sec. 611, are not deductible under Sec. 174, irrespective of the fact that the property or improvements



# SECTION 174

## RESEARCH AND DEVELOPMENT CREDIT REVISED REGULATION ANALYSIS



may be used by the taxpayer in connection with research or experimentation.”<sup>17</sup> The allowance for depreciation of the test bed does qualify for Sec. 174 treatment, to the extent the test bed is used in the research or experimentation of other products.

The third example assumes that \$50,000 of the \$5,000,000 were costs related to eliminating uncertainty concerning the new test bed’s design. Amounts expended for research or experimentation do not include the costs of the component materials of the depreciable property, the costs of labor or other elements involved in its construction and installation, or costs attributable to the acquisition or improvement of the property. Therefore, the \$50,000 would qualify for Sec. 174 treatment as depreciable property limited to amounts expended for research or experimentation under Sec. 1.174-2(b)(2).

### Conclusion

The expanded definitions and additional examples for the regulation clarifying IRC Sec. 174 have removed uncertainties taxpayers face when determining whether or not expenditures qualify as R&D expenses. Under TD 9680, the IRS and the Treasury Department did an excellent job of incorporating taxpayer comments. We would expect the IRS and the Treasury Department to continue working to clarify the regulation to make implementation easier in the future. **EA**

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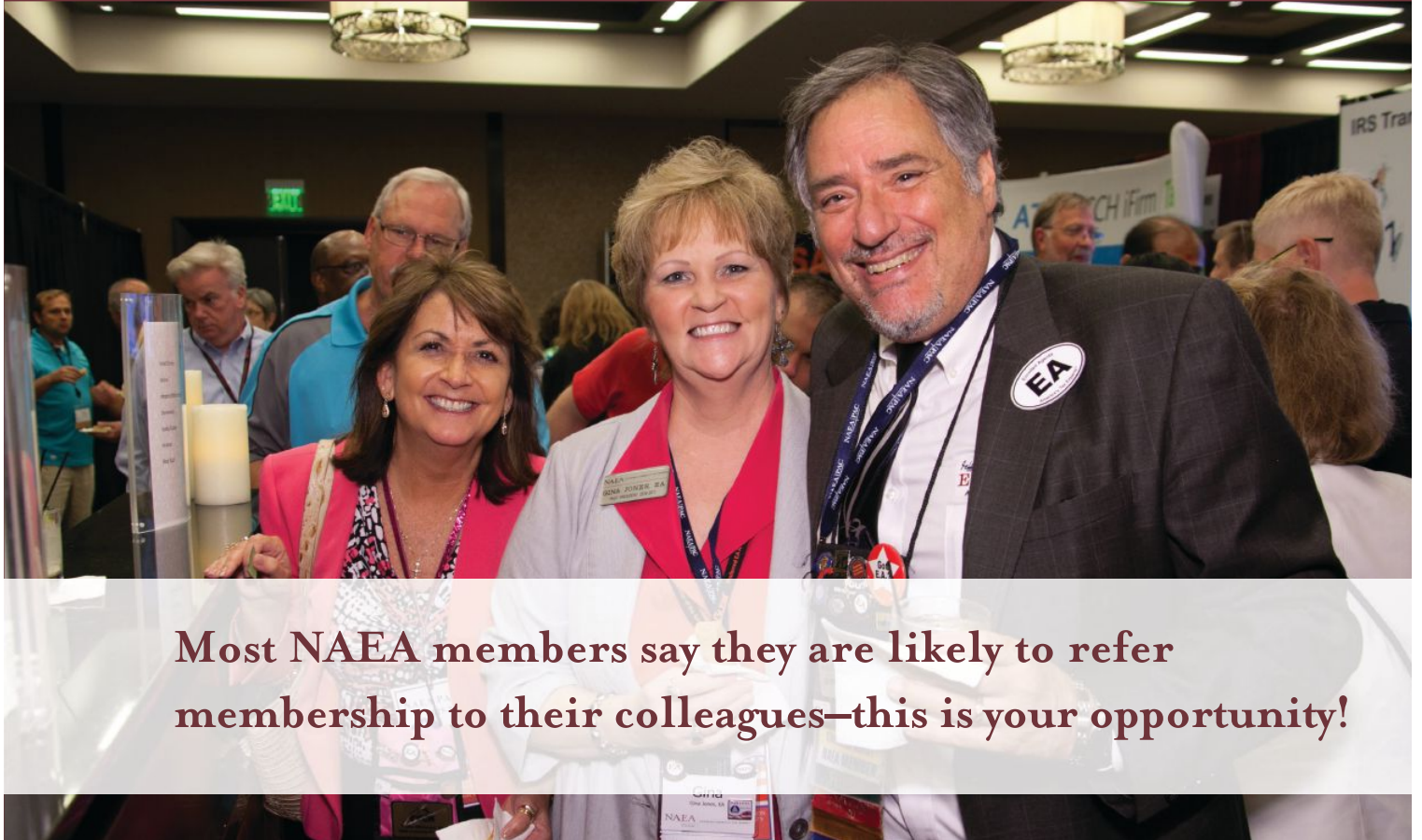
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A magnifying glass with a wooden handle and a metal rim is positioned over a tax form. The lens is focused on the text '2016 Tax Law Wrap-Up' and 'BY DAVID MELLEM, EA'. The background shows a blurred tax form with various fields and instructions.

# 2016 Tax Law Wrap-Up

BY DAVID MELLEM, EA



**C**ongress did finally take action on the “extenders” last December, but it has not done very much this year. Some of the extenders were made permanent, and some were extended for a set period of time, such as two years. The items extended for two years are again expiring on December 31, 2016, and have so far not been extended further, which means we are again faced with uncertainty on these items.

### Form 1099

As we mentioned last year, the Form 1099 penalties increased effective with Forms 1099 that were required to be filed after December 31, 2015. This means the ones we prepared last January were subject to these higher penalties. This penalty amount is also now subject to be increased due to inflation. The penalty amount has increased from last year’s \$250 to \$260 for this year.

### Education Credits and Tuition Deduction

The American Opportunity Credit is now permanent as currently written. The Tuition Deduction is extended through December 31, 2016.

Beginning with calendar year 2016, educational institutions are now required to show the amounts of qualified expenses *paid* on Form 1098-T (Tuition Statement). However, many institutions told IRS they are having difficulty getting their software programs changed for this year, so IRS gave them an extra year. Therefore, this requirement to show the tuition paid will not apply until the calendar year 2017. As in years past, we will continue to have to ask our clients for the amounts they *paid* during the year and not trust the Form 1098-T’s “billed” amounts.

### Delayed Refunds

Effective for tax years beginning after December 31, 2016, the refund shown on a Form 1040 series return that contains earned income credit (EIC) or the refundable Child Tax Credit will not be issued before February 15. This is intended to give

IRS more time to conduct fraud checks on the return.

### Retroactive Refund Claims Denied

In the past, a taxpayer with an individual taxpayer identification number (ITIN) who later obtained a valid social security number (SSN) was able to amend prior-year returns to claim EIC, the American Opportunity Credit, and the refundable Child Tax Credit.

This ability to amend is no longer available for tax years beginning *after* December 31, 2014, if the SSN was obtained after the due date for filing the original return. There is an exception to this denial for a tax year beginning in 2015 as long as the original 2015 return was timely filed.

### Denial of EIC, American Opportunity Credit and Refundable Child Tax Credit

Effective for tax years beginning after December 31, 2015, a taxpayer is not allowed the EIC, American Opportunity Credit, or the refundable Child Tax Credit if the taxpayer has improperly claimed the applicable credit.

This denial is for a period of two years if the claim is denied due to reckless or intentional disregard of the rules. The denial is for a period of 10 years if the claim is denied due to fraud.

### Depreciation Changes Section 179

The \$500,000 maximum is permanent and is now indexed for inflation. The \$2,000,000 phase-out level is permanent and is now

indexed for inflation (\$2,010,000 for 2016). The maximum amount of Sec. 179 that can be used for qualified real estate improvements is now the full Sec. 179 amount. Off-the-shelf software is permanently eligible to be claimed under Sec. 179. The ability to amend to claim more or less Sec. 179 is also permanent. Air conditioning and heating units are now eligible for Sec. 179, and this is permanent.

Film and TV production expensing under Sec. 179 has been extended through tax years beginning prior to January 1, 2017. This has been expanded and includes certain live productions.

### Depreciable Lives

The fifteen-year life for qualified leasehold improvements, qualified retail establishment improvements, and qualified restaurant improvements has been made permanent.

The seven-year life for motorsports racing track facilities is available for assets placed in service in tax years beginning prior to January 1, 2017.

The three-year life for race horses is available for assets placed in service in tax years beginning prior to January 1, 2017.

### Bonus Depreciation

Bonus depreciation has been extended, phased out, and expanded:

- 50 percent bonus is available for assets placed in service prior to January 1, 2018. The first-year limit for vehicles falling under the listed property limitations is increased by \$8,000.
- 40 percent bonus is available for assets placed in service during calendar year 2018. The first-year limit for vehicles



falling under the listed property limitations is increased by \$6,400.

- 30 percent bonus is available for assets placed in service during calendar year 2019. The first-year limit for vehicles falling under the listed property limitations is increased by \$4,800.
- For plants planted or grafted after December 31, 2015, and before January 1, 2020, bonus depreciation is allowed for trees, vines, and plant-bearing fruit or nuts when planted or grafted, instead of when they are placed in service.

## Extenders

### Other Extenders Made Permanent

- Research Credit, with some modifications
- S corporation basis reduction for contributions of noncash property
- S corporation built-in gain period of five years
- Exclusion under Sec. 1202 of 100 percent of the gain from certain small business stock
- Enhanced deduction of food inventory
- Employer wage credit for employees who are active duty members of the uniformed services
- The educator deduction is permanent and now includes professional development. The \$250 limit is indexed in \$50 increments.
- Sales tax deduction
- Tax-free distributions from IRAs direct to charities for taxpayers who have reached age 70½
- Transit passes and qualified parking now have parity (\$255 for 2016).

### Extended through December 31, 2016

- 10 percent Energy Credit for storm windows and doors, insulation, etc.
- Mortgage insurance premiums as itemized deductions
- Cancellation of indebtedness exclusion for principal residence

acquisition indebtedness of a maximum of \$2,000,000

- Alternative Fuel Vehicle Recycling Property Credit
- Two-Wheeled Plug-in Vehicle Credit
- Energy Efficient Home Credit (aka, Builder's Credit) of \$1,000 or \$2,000
- Energy Efficient Commercial Building Property deduction under Sec. 179D
- Credit for fuel-cell vehicles
- Indian Employment Credit
- Domestic Production Activities Deduction for Puerto Rico
- Empowerment Zone Credit

### Extended Through Various Dates

- Work Opportunity Credit through 2019 with changes
- New Markets Tax Credit through 2019
- The medical device excise tax is postponed until after December 31, 2017.
- 40 percent tax on Cadillac health plans is postponed for two years.
- 30 percent credit for facilities using wind to produce electricity is extended through tax years beginning prior to January 1, 2020. The credit is phased out as follows:
  - 20 percent phase out for tax years beginning after December 31, 2016
  - 40 percent phase out for tax years beginning after December 31, 2017
  - 60 percent phase out for tax years beginning after December 31, 2018
- The 30 percent credit for solar energy property is extended through years beginning prior to January 1, 2022. This credit also has some modifications and lower credits.

### Exclusion for Income Received for Wrongful Incarceration

Income received by a wrongfully incarcerated individual for civil damages, restitution, or other monetary award is not taxable.

This provision is available for any open year. If a year is closed, it appears the taxpayer can still get a refund as long as the claim is filed no later than December 19, 2016 (one year from the date Protecting Americans from Tax Hikes Act of 2015 (PATH Act) was signed into law plus one day since December 18 falls on a Sunday).

The amended return should have "Incarceration Exclusion PATH Act" written at the top of the Form 1040X (Amended U.S. Individual Income Tax Return).

IRS set up a special filing address for amended returns claiming this exclusion. Form 1040X, along with supporting documentation, should be sent to:

Internal Revenue Service  
333 W. Pershing  
Stop 6503 5th Fl  
Kansas City, MO 64108

IRS has provided a set of FAQs on its website. Question 8 has information about the documentation that should be submitted with Form 1040X. See below:

Q8: What documentation should a wrongfully incarcerated individual submit with his or her amended federal income tax return (Form 1040X) to substantiate the claim for refund?

A8: The Form 1040X must include two different types of documentation. The first type of documentation must establish that the award was previously reported in income, when it was reported, and in what amount. Examples of such documentation include copies of federal income tax returns, Forms 1099-MISC (Miscellaneous Income), and any other retained records relating to the reported income. However, if a wrongfully

## IRS is to provide a streamlined recognition process for organizations seeking tax exemption under Sec. 501(c)(4).

incarcerated individual no longer has documentation establishing that he or she previously reported the award in income, then he or she must submit a written statement affirming that the income was reported and that he or she no longer has relevant records. The second type of documentation must establish that the award was made on account of the wrongful incarceration. Examples of such documentation include copies of federal or state court orders awarding the compensation, signed settlement agreements accepting the amount of the award, and letters by governmental agencies or private payment sources that may have accompanied the payment of the award that include an explanation of the reason for the payment.

### Streamlined Exemption Process

IRS is to provide a streamlined recognition process for organizations seeking tax exemption under Sec. 501(c)(4).

Instead of the current process, these organizations must file a simple one-page notice of registration with IRS within 60 days of the organization's formation. Within 60 days after an application is submitted, IRS must provide a letter of acknowledgement of the registration, which the organization can use to demonstrate its exempt status. Certain limitations apply.

Rev. Proc. 2016-41 was released July 8, 2016. It announced the new Form 8976

(Notice of Intent to Operate under Sec. 501(c)(4)) to be used for this streamlined process. The form can only be filed electronically through IRS's website; it cannot be filed in paper format. Specific directions on this process can be found by going to [www.irs.gov](http://www.irs.gov) and entering "8976" in the search box. There is a \$50 fee for the processing of this form.

### Social Security Numbers on Form W-2

IRS has been given the *authority* to require employers to include an identifying number for each employee, rather than the employee's SSN, on Forms W-2. Watch for further information from IRS.

### Enrolled Agent Designation

Enrolled agents approved by IRS are now permitted to use the designation "enrolled agent," "EA," or "E.A."

Apparently, there was disagreement in some states about EAs' right to use their credential. It was felt in those states that the EA credential and abbreviation were too easily confused with the CPA credential and abbreviation.

Now the federal government has taken control of this issue and permits the designations to be used in all states.

### Di Minimis Corrections on Forms W-2 and 1099

IRS does not require a Form W-2 or 1099 to be corrected if:

- The income amount is incorrect by \$100 or less.

- The federal income tax withholding is incorrect by \$25 or less.

### Due Date for Submitting W-2s to the Social Security Administration

The new due date for submitting Forms W-2 and W-3 (that report employee compensation) to SSA and Form 1099-MISC (that report nonemployee compensation in Box 7) to IRS is now January 31, instead of the prior February 28, effective with forms for calendar years beginning after December 31, 2015.

Form 8809 (Application for Extension of Time to File Information Returns) can be filed to request a 30-day extension of time to file these forms. This is not an automatic extension.

As in the past, this extension does not extend the time to get the returns to the employees. To request an extension to provide Forms W-2 to employees, the employer must send a letter to IRS as provided in the instructions to Form W-3.

### Repair Versus Capitalization Regulations Safe Harbor Options

Over the past several years, you have heard about the safe harbor amounts available for the definition of "materials and supplies," including the \$200 level, the \$500 level, and the \$5,000 level.

The \$500 level has now increased to \$2,500 effective for tax years beginning after December 31, 2015. IRS announced it will not question at examination, appeals, or court the use of this \$2,500 level for



any tax year beginning after December 2011, and ending prior to January 1, 2016.

### **Last Year's Provisions That First Take Effect This Year Public Safety Employee**

The exception from the 10 percent early distribution penalty for public safety employees is changed to include federal employees who are law enforcement officers, customs and border protection officers, firefighters, or air traffic controllers effective with distributions after December 31, 2015. (Section 72(t)(10))

### **Due Dates of Various Return Changes Partnerships:**

Effective for taxable years beginning after December 31, 2015, the due date for partnership tax returns becomes the 15th day of the third month after the end of the partnership's tax year. This means the due date for unextended calendar-year partnership tax returns becomes March 15, the same due date as S corporation tax returns. Congress also dictates to IRS that the maximum extension period for calendar-year partnership tax returns cannot exceed one six-month period. IRS can choose a shorter period of time if it desires.

**C Corporations:** Effective for taxable years beginning after December 31, 2015, the due date for C corporation tax returns also changes. The due date is changing to the 15th day of the *fourth* month after the end of *most* C corporations' tax years.

This sounds simple enough, but that isn't the whole story. There is a special rule that *keeps* the due date for a fiscal year C corporation using a taxable year ending June 30 as the 15th day of the *third* month after the end of its fiscal year, which means the due date for C corporation returns with a June 30 year end is September 15. These June 30 fiscal

year C corporation returns will have their due dates change to the 15th day of the *fourth* month effective for taxable years beginning after December 31, 2025—10 years after all other C corporations. (The Act does not specify why this special rule exists. All we can come up with is that the government fiscal year ends September 30, so a due date of September 15 causes the revenues to fall near the end of the government's fiscal year instead of at the beginning of the next fiscal year. We believe there is a provision in the law that says something about tax bills having to be able to be balanced over a 10-year period.)

Here is a summary of C corporation return due dates:

- All year-ends except June 30 = 6 months
- June 30 year ends = 5 months until 2026, then 6 months

### **Extensions for C Corporations**

Congress dictates the maximum extension period is one six-month period (the law previously said one automatic three-month period, with another three-month non-automatic extension available, but IRS gave us a six-month automatic period anyway, so Congress is merely formalizing this).

There's more. As we said, the automatic extension period is a maximum six-month period, but a C corporation that has a December 31 tax-year end has a maximum five-month period for its extension for all tax years beginning prior to January 1, 2026. Effective for tax years beginning on or after January 1, 2026, calendar year-end C corporations will have the normal six-month extension period. This means calendar year C corporations will have an April 15 due date but a September 15 extended due date for the next 10 years!

Also, a C corporation that has a June 30 tax-year end has a maximum seven-month period for its extension for all tax years beginning prior to January 1, 2026.

Here is a summary of extended C corporation returns' due dates:

- All year-ends except December 31 and June 30 = 6 months
- December 31 year-ends = 5 months until 2026, then 6 months
- June 30 year-ends = 7 months until 2026, then 6 months

### **FinCEN Report 114**

Effective for taxable years beginning after December 31, 2015, the due date for the FinCEN Report 114 (FBAR) will be April 15, and there is now an extension available for a maximum of one six-month period. Also, the secretary can waive penalty for failure to timely request for, or file, an extension for a taxpayer required to file this form for the first time.

### **Form 1098, Mortgage Interest Statement**

Effective with statements required to be furnished after December 31, 2016, the Form 1098 will include the following new information:

- the amount of the outstanding principal at the beginning of the year
- the date of the origination of the mortgage
- the address of the property that secures the mortgage

Here's to a happy, successful, and stress-free tax season! **EA**

### **About the Author:**

**David Mellem, EA**, has been practicing for more than 20 years. He and his wife Mary own Ashwaubenon Tax Professionals in Green Bay, Wisconsin. David also consults and teaches for other tax professionals throughout the country. David can be reached at davidmellem@yahoo.com.

# Tax Appointment Worksheet

The Tax Appointment Worksheet is a tool to help you gather the needed information for new and returning clients for the 2016 tax year. This year's worksheet has been enhanced to reflect the changes in tax law. Now that the American Opportunity Credit is permanent, the need for the proper Form 1098-T and the educational expense evidence is increasingly crucial.

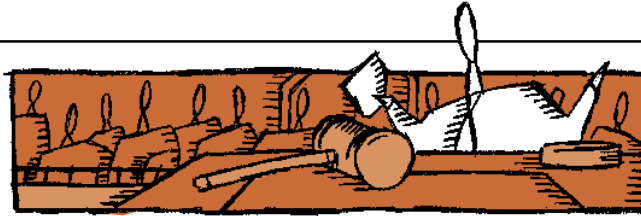
EVENT		DOCUMENTS OR INFORMATION NEEDED
1	Married, divorced, or separated in 2016	<ul style="list-style-type: none"> <li>Married – prior year return of both spouses</li> <li>Divorced – finalized date, copy of divorce decree</li> <li>Separated – copy of the separate maintenance agreement</li> <li>Community property income allocation</li> </ul>
2	Birth or adoption	<ul style="list-style-type: none"> <li>Social Security cards and adoption papers</li> </ul>
	Adoption credit	<ul style="list-style-type: none"> <li>Expenses date and amount, date of adoption, special needs certification</li> </ul>
3	Death of child or spouse	<ul style="list-style-type: none"> <li>Date of death</li> </ul>
4	Additional members of household	<ul style="list-style-type: none"> <li>Date of occupancy and relationship</li> </ul>
5	Job change	<ul style="list-style-type: none"> <li>Start date</li> <li>Name of new employer</li> <li>W-2s from new and old employers</li> </ul>
6	Unemployment	<ul style="list-style-type: none"> <li>Unemployment form</li> </ul>
7	Retirement contribution	<ul style="list-style-type: none"> <li>Type of plan</li> <li>Amount of contribution</li> </ul>
8	Retirement distributions	<ul style="list-style-type: none"> <li>Form 1099-R</li> <li>Rollovers</li> <li>RMD information if 70½ or older</li> </ul>
9	Social Security benefits	<ul style="list-style-type: none"> <li>Form 1099-SSA</li> </ul>
10	Sale of stocks, bonds, etc. (including mergers)	<ul style="list-style-type: none"> <li>Form 1099-B or other sale documents</li> <li>Basis or original costs</li> </ul>
11	Purchase of stocks, bonds, etc., personal residence, or other real estate	<ul style="list-style-type: none"> <li>Purchase documents, closing papers</li> </ul>
12	Inheritance	<ul style="list-style-type: none"> <li>Will, K-1 from the estate</li> <li>Basis information</li> </ul>
	Gifts made or gifts received	<ul style="list-style-type: none"> <li>Cash or property in excess of \$14,000 per person</li> <li>Description of property given, basis, donee name</li> <li>Property – basis of donor</li> </ul>
13	Trade of any property (real estate, vehicle, etc.)	<ul style="list-style-type: none"> <li>Date of trade, property given up and property received, basis and FMV</li> <li>Qualified intermediary sales agreements or closing papers</li> </ul>
14	Start or end a small business (Schedule C, LLC, S or C Corp, Partnership)	<ul style="list-style-type: none"> <li>Formation or termination dates</li> <li>Property contributions or distributions</li> <li>K-1s, if applicable</li> </ul>
	Business income/expenses	<ul style="list-style-type: none"> <li>1099-Ks received for use of credit cards</li> <li>Inventory numbers, if applicable</li> <li>Mileage information</li> </ul>
15	Lawsuit settlements	<ul style="list-style-type: none"> <li>Date received</li> <li>Reason for the settlement</li> <li>1099-MISC</li> </ul>

<b>16</b>	<b>Rental property</b>	<ul style="list-style-type: none"> <li>• Income</li> <li>• Expenses</li> <li>• New property purchased</li> </ul>
<b>17</b>	<b>Prizes</b>	<ul style="list-style-type: none"> <li>• Form 1099-MISC</li> <li>• Value of prizes not included on Form 1099-MISC</li> </ul>
<b>18</b>	<b>Lottery or gambling winnings</b>	<ul style="list-style-type: none"> <li>• Total amount won whether on W-2G or not</li> <li>• Total amount of losses</li> </ul>
<b>19</b>	<b>Health insurance, medical, dental, or drug expenses</b>	<ul style="list-style-type: none"> <li>• Health insurance premiums</li> <li>• Post-tax payments</li> <li>• Totals of other medical, dental, and drug expenses. If the health insurance is pre-taxed (i.e. cafeteria plan, Sec. 125, POP), premiums have already been deducted from the wage</li> <li>• Health Savings Account (HSA) information</li> </ul>
	<b>Medical miles (19 cents per mile)</b>	<ul style="list-style-type: none"> <li>• Total medical miles driven January–December</li> </ul>
	<b>Health insurance coverage verification</b>	<ul style="list-style-type: none"> <li>• Form 1095 A, B, or C must be received from the marketplace, the insurance carrier, or your employer for every person included on the tax return.</li> </ul>
<b>20</b>	<b>State taxes income, property taxes paid, sales tax paid on vehicles, motorcycles, or homes</b>	<ul style="list-style-type: none"> <li>• Prior year's income tax return</li> <li>• Property tax bills</li> <li>• Closing papers from the purchase or sale of property</li> <li>• Letter from the state regarding any change in a prior-filed return</li> </ul>
<b>21</b>	<b>Refinance a home</b>	<ul style="list-style-type: none"> <li>• Closing papers with amount borrowed</li> <li>• Form 1098</li> <li>• Description of use of money</li> </ul>
<b>22</b>	<b>First-time homebuyer credit</b>	<ul style="list-style-type: none"> <li>• Credit no longer available</li> </ul>
	<b>Recapture/repayment 2008 credit</b>	<ul style="list-style-type: none"> <li>• Sale or change in use</li> <li>• Record of amount repaid—Year 7 of 15</li> </ul>
<b>23</b>	<b>Charitable contributions of money, property, or out-of-pocket expenses</b>	<ul style="list-style-type: none"> <li>• Date, amount, and type of contributions</li> <li>• Knowledge that receipts from the organizations have been received</li> <li>• Statement regarding whether goods and services were received for donation</li> <li>• Mileage log for charitable work</li> <li>• Form 1098-C for vehicle or boat donations</li> </ul>
	<b>Charitable miles (14 cents/mile)</b>	<ul style="list-style-type: none"> <li>• Total charitable miles driven</li> </ul>
	<b>Transfer of IRA to charity</b>	<ul style="list-style-type: none"> <li>• Brokerage statement showing transfer (1099 R)</li> </ul>

<b>24</b>	<b>Job-related expenses</b>	<ul style="list-style-type: none"> <li>• Meals, lodging, and miscellaneous expense amounts for items related to employment</li> </ul>
	<b>Business miles (54 cents per mile)</b>	<ul style="list-style-type: none"> <li>• Total miles driven per vehicle: January–December</li> <li>• Business miles driven per vehicle: January–December</li> </ul>
<b>25</b>	<b>Education expenses</b>	<ul style="list-style-type: none"> <li>• Form 1098-T for parents or children; if the child is a student, the form will come to the child.</li> <li>• Actual expense record to verify expenses for credit/ deduction purposes</li> <li>• Financial transcript from school needed to show when actual expenses were paid</li> </ul>
	<b>Student loan interest</b>	<ul style="list-style-type: none"> <li>• Interest record for student loans</li> <li>• Form 1098-E</li> </ul>
<b>26</b>	<b>Child or disabled spouse care</b>	<ul style="list-style-type: none"> <li>• Name, address, and ID number of the day-care provider</li> <li>• Amount paid to the provider (if the provider comes into your home, a W-2 may be required)</li> </ul>
<b>27</b>	<b>Energy credit</b>	<ul style="list-style-type: none"> <li>• Information regarding the purchase of solar, geothermal, fuel cell, or small wind energy property business or residence</li> <li>• Windows, insulation, and other personal energy upgrades, as well as information regarding the previous use of the credit</li> </ul>
<b>28</b>	<b>Bankruptcy filing</b>	<ul style="list-style-type: none"> <li>• Date filed</li> <li>• Bankruptcy papers to show property rejected/returned by court</li> </ul>
<b>29</b>	<b>Debt forgiveness or abandonment of property</b>	<ul style="list-style-type: none"> <li>• Form 1099-A for abandonment</li> <li>• Date property was taken by the bank or sold in foreclosure</li> <li>• Form 1099-C for cancellation</li> </ul>
<b>30</b>	<b>IRS or state communications</b>	<ul style="list-style-type: none"> <li>• Letters, additional taxes paid, changes in prior-year returns, installment agreements, or offers in compromise</li> </ul>
<b>31</b>	<b>Foreign investments or holdings</b>	<ul style="list-style-type: none"> <li>• Any foreign accounts?</li> <li>• Any greater than \$10,000?</li> <li>• Foreign business interests or stock of \$50,000 or more?</li> <li>• Signature authority over foreign accounts?</li> </ul>

### About the Author

**Mary R. Mellem, EA**, is a tax professional from Green Bay, Wisconsin who has been in the tax business for thirty-two years. She and her husband David operate Ashwaubenon Tax Professionals. In addition to servicing 1,200 tax and accounting clients during the year, their business includes tax consulting for other tax professionals as well as teaching tax seminars around the country. To contact Mary, write to [marymellemea@yahoo.com](mailto:marymellemea@yahoo.com).



TAX COURT CORNER

## Can IRS Levy a Taxpayer If It Previously Mailed a Notice of Deficiency to an Address That Was Not the Taxpayer's Last Known Address?

David Buffano, Petitioner

v.

Commissioner of Internal Revenue, Respondent

T.C. Memo 2016-122

By Steven R. Diamond, CPA

**IRC Sec. 6321 imposes a lien in favor of the United States on all property and rights to property after a demand for taxes has been made and the taxpayer fails to pay the taxes. The IRS must first notify a taxpayer in writing of his or her right to a hearing on the issue of whether the lien is appropriate. A taxpayer may challenge the existence or amount of the underlying tax liability but only if a notice of deficiency was not received or the taxpayer did not otherwise have an opportunity to dispute the liability.**

### FACTS

Mr. Buffano (petitioner) did not file federal income tax returns for the years 2000–2003. The IRS sent a separate notice of deficiency for each year at issue. IRS subsequently sent petitioner a Final Notice of Intent to Levy and Notice of Your Right to a Hearing with

respect to petitioner's federal income tax liabilities for years 2002 and 2003. IRS also sent petitioner a Notice of Federal Tax Lien Filing and Notice of Your Right to a Hearing with respect to tax years 2000–2003.

Petitioner timely submitted his request for a collection due process or

equivalent hearing with respect to the notices he received. Petitioner asserted in his response to the levy that he was challenging whether IRS followed proper procedure and whether the liability was even owed.

IRS Appeals subsequently mailed notices of determination to petitioner and stated that all procedures were properly followed and the lien filing was appropriate; Appeals also sustained the proposed IRS levy. Neither response specifically addressed petitioner's underlying tax liability for any of the years at issue or whether a notice of deficiency for any of those years was properly mailed to petitioner's last known address, or otherwise received by him.

After setting the case for trial, the IRS asked to postpone the trial date because it was determined that the IRS settlement officer failed to properly consider petitioner's underlying tax liabilities for the years at issue. Subsequently, IRS Appeals mailed supplemental notices to the petitioner advising him that he was not entitled to relief from the filing of the Notice of Federal Tax Lien nor was he entitled

### 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 an MSM 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.

to relief from the proposed collection actions. Those notices advised petitioner that Appeals had mailed him copies of the notices of deficiency for years 2002 and 2003, but it could not demonstrate that the original notices were mailed to his last known address.

### OPINION

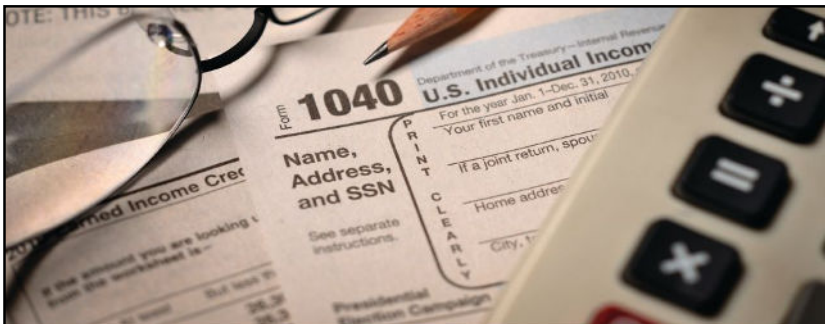
At trial, petitioner claimed IRS did not properly mail him a notice of deficiency for any years at issue. The IRS conceded that petitioner did not receive a notice of deficiency, but it asserted that a notice of deficiency for each year was mailed to his last known address. The IRS did not introduce any evidence to support its assertion.

As stated in *Hoyle v. Commissioner*<sup>1</sup> and *Freije v. Commissioner*,<sup>2</sup> a collection action will not be sustained when the underlying liability is premised on an invalid assessment. The commissioner must first mail a statutory notice of deficiency to a taxpayer's last known address. Additionally, in the *Coleman*<sup>3</sup> case, it is noted that the commissioner bears the burden of proving—by competent and persuasive evidence—that a notice of deficiency was properly mailed.

In this case, the deficiencies that gave rise to the underlying tax liabilities were not properly assessed if the commissioner did not mail notices of deficiency to petitioner's last known address. IRS's admission in the supplemental notices that it was unable to show that notices of deficiency for the years at issue were mailed to the last known address of the petitioner required the Tax Court to find that the assessments sought to be collected were invalid. As a result, the supplemental notices that upheld the lien filing and proposed levy action were not sustained, and the Tax Court entered a decision in favor of the petitioner. **EA**

### ENDNOTES

1. *Hoyle v. Commissioner*, 131 T.C. 197
2. *Freije v. Commissioner*, 125 T.C. 14
3. *Coleman v. Commissioner*, 94 T.C. 82



## \$24.1 billion in penalties were assessed on 2015 tax returns.

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Or contact us and we'll be happy to answer any questions you may have.

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APPROVED  
CONTINUING EDUCATION  
PROVIDER

# Two-Hour Online Home CE Test

November/December 2016  
IRS Program Number: X9QQU-T-00389-16-S  
2 CE

The following test will provide two hours of CE credits. The test questions are drawn from the articles in this issue. The CE test must be taken online.

## INSTRUCTIONS

You will need your login and password to take the test online. All questions must be answered before the test is complete. Once you have marked all your answers, entered your credit card information, and clicked "Submit Test and Payment," your test will be graded immediately. Please complete the test before leaving your computer, otherwise the system will time-out and your responses will be lost. You cannot leave and return to a test. To qualify for CE credit, you must complete the test within one year of the publication date. Members \$35, nonmembers \$45 for 20 questions.

### PFIC RULES AND THE IMPLICATIONS

1. A foreign corporation would be defined as a PFIC if \_\_\_% or more of the corporation's gross income is passive income.

- A. 25
- B. 50
- C. 75
- D. 80

2. PFICs provide the benefit of tax deferral for all passive investments by foreign entities.

- A. True
- B. False

3. A QEF election must generally be made by:

- A. April 15
- B. Due date for the return (including extensions)
- C. October 15
- D. June 15

4. Deferred yearly tax amounts on an excess distribution are calculated using the \_\_\_ in effect in the years the income was accumulated.

- A. Tax rate in effect based on the taxpayer's income and filing status
- B. Capital gains tax rate
- C. Highest tax rate
- D. Lowest tax rate

5. Form 8621 is not required for a direct disposition as long as the aggregate value of the U.S. taxpayer's PFIC stock is \$25,000 or less.

- A. True
- B. False

6. Disposition of PFIC stock refers to:

- A. Sale of PFIC stock
- B. Purchase of PFIC stock
- C. Dividends paid on PFIC stock
- D. Making a PFIC election



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**SEC. 174: RESEARCH AND DEVELOPMENT**

7. Research and experimentation expenditures are defined by Sec. 174 as the expenditures incurred in connection with the taxpayer's trade or business which represents research and development costs in the experimental or laboratory sense.

- A. True
- B. False

8. The cost of obtaining a patent does not qualify as an R&D expenditure.

- A. True
- B. False

9. Expenditures made by the taxpayer to acquire or improve land or any property which is subject to an allowance for depreciation or depletion are deductible under Sec.174, regardless of whether the property is used by the taxpayer in connection with research and experimentation.

- A. True
- B. False

10. As per TD 9680, the proposed regulations defined pilot model as any representation or model of a product that is produced to evaluate and resolve uncertainty concerning the product during the development or improvement of the product.

- A. True
- B. False

11. The costs of producing pilot models and the costs of testing pilot model qualify for Sec. 174 deductions.

- A. True
- B. False

**2016 TAX LAW CHANGES**

12. Which of the following items will delay the refund of a Form 1040 series return to February 15?

- A. American Opportunity Credit
- B. Earned Income Tax Credit
- C. Home Energy Credit
- D. Work Opportunity Tax Credit

13. The phaseout level for Sec. 179 for purchases in tax years beginning after December 31, 2015 is:

- A. \$100,000
- B. \$500,000
- C. \$1,000,000
- D. \$2,010,000

14. Bonus depreciation for assets placed in service in calendar year 2016 is:

- A. 0%
- B. 30%
- C. 40%
- D. 50%

15. Which of the following items was not extended permanently?

- A. Educator deduction
- B. Sales tax deduction
- C. Tax-free distributions from IRAs direct to charities for taxpayers who have reached age 70½
- D. Two-wheeled Plug-in Vehicle Credit

16. Which of the following items was extended permanently?

- A. 10 percent Energy Credit for storm windows, insulation, etc.
- B. Credit for fuel-cell vehicles
- C. Indian Employment Credit
- D. Research Credit

17. The S corporation built-in gains period is now \_\_\_\_ years.

- A. 5
- B. 7
- C. 10
- D. 20

18. Which of the following C corporation year-ends does not have a six-month extension for its income tax returns after this year:

- A. December 31 and June 30
- B. December 31 and March 31
- C. June 30 and September 30
- D. March 31 and September 30

**TAX COURT CORNER**

19. In the *Buffano* case, IRS Appeals mailed notices of determination to petitioner and stated that all procedures were properly followed and the lien filing was appropriate.

- A. True
- B. False

20. The Tax Court ultimately determined that:

- A. The lien and levy were appropriate
- B. The taxpayer did not pay his taxes for the years at issue, therefore, he needed to pay them, as due process does not apply to someone who doesn't file tax returns
- C. The lien and levy were invalid as the IRS had not mailed notices of deficiency to the taxpayer's last known address
- D. The commissioner needed to issue an apology to the taxpayer, then the IRS could levy the taxpayer's assets

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By Gigi Thompson Jarvis, CAE

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These quotes from the attendee evaluations at this year’s NAEA annual conference at the Cosmopolitan of Las Vegas tell the story. Nearly 700 tax professionals came together in early August to learn and earn 24 CE credits at the National Tax Practice Institute™ (NTPI®) in Levels 1, 2, and 3, the Graduate Level in Representation, and the Tax Preparation Issues Track.

In addition to the outstanding courses, program highlights included three complimentary “Lunch and Learns,” a pre-conference seminar, a welcome reception, the NAEA Annual Meeting, and a PAC reception.

On Wednesday, August 3, NAEA honored nine outstanding individuals at the annual awards ceremony in recognition of their significant contributions to the association and the enrolled agent profession. (Be sure to read the January/February issue of the *EA Journal* for the full story on the award winners.) Then, the graduates of NTPI Level 3 took their walk across the stage to receive the NTPI Fellow® certificate, congratulation from the instructors, and the applause of friends, families, and fellow tax professionals.

The following day, the August 2016 NAEA Board of Directors meeting was held. Next year’s national conference will be held once again at the luxurious Cosmopolitan of Las Vegas, July 31–August 2. If you don’t want to wait that long to progress on your path to becoming an NTPI Fellow, please join us in Orlando, November 9–11 of this year, when NTPI Levels 2 and 3 will be offered. More information on NAEA education can be found at [www.naea.org](http://www.naea.org) or by contacting [education@naea.org](mailto:education@naea.org).



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The NAEA Board and staff are pleased to welcome the following new members to NAEA who enrolled during August and September 2016!

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