The Uncanny Cannabis Controversy • Taxation and Crowdfunding

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HOW TO MAXIMIZE PENALTY RELIEF FOR YOUR CLIENTS

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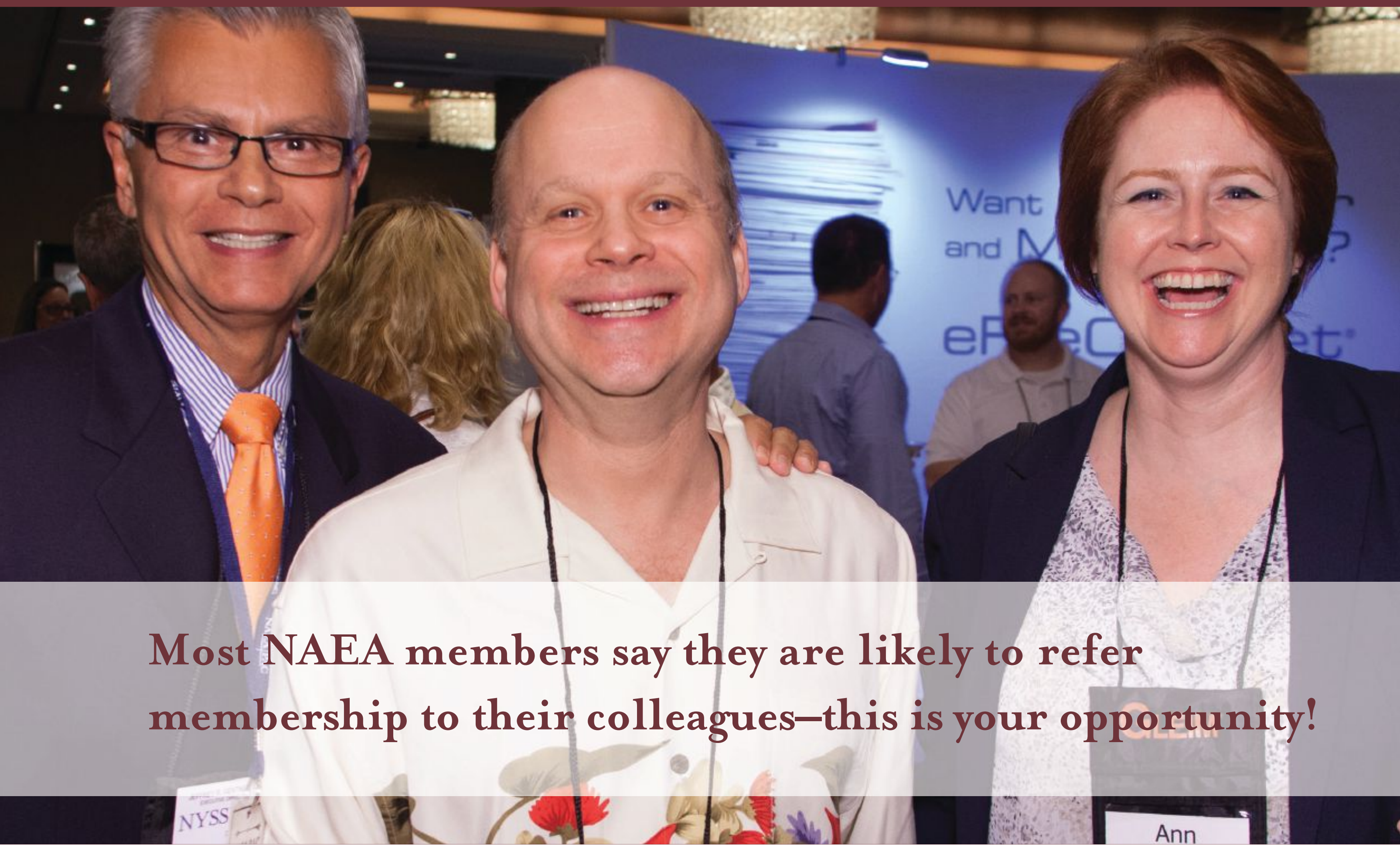

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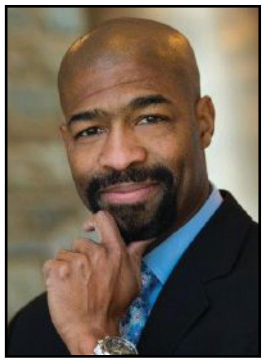
A New Day



A. Cedric Calhoun, CAE, FASAE

I am honored and privileged to be leading an organization like the National Association of Enrolled Agents. I started here a little over nine months ago, and it has been nonstop from day one.

Let me start by stating that I will make no excuses. There is work to be done, and it will be done to benefit NAEA as an organization and its members as professionals. That being said, NAEA has a number of challenges that will be overcome with diligent care and tough measures.

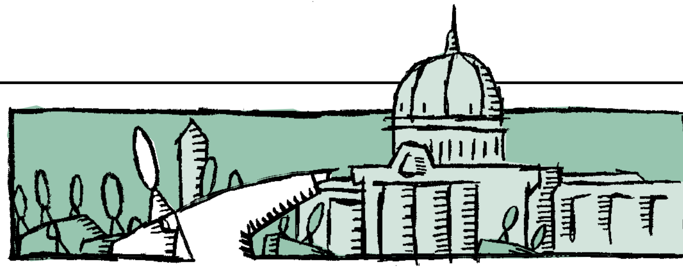
I am a self-proclaimed data geek, and in my short time here, I have been able to uncover some deficiencies in information that have prevented the organization from being as effective as it could have been in the past. For whatever reason, financial or otherwise, decisions were made by my predecessors not to migrate what I consider to be critical data that would enable the NAEA board and staff to make informed decisions as to the future of the organization. Hunches are good. Data is great. Hunches plus data give you the information you need to make key decisions. Data gathering is a key focus area for NAEA in the coming year.

NAEA will have to conduct its business affairs differently in order to remain relevant and sustain its financial soundness. The following phrase is prominently displayed in our office's kitchen area: "You can't do today's job with yesterday's methods and expect to be in business tomorrow." The organizational structure is dated and the tough work of creating a different culture has begun.

Departmental silos are being broken down and replaced with an integrated model whereby staff can connect the dots, so to speak, and see the common work being performed across the organization. It requires everyone to know what is going on in other departments and how their own activities may intersect with others to create a stronger program, product, or service for our members. We are moving beyond just "getting the work done" to "getting the right work done" for the benefit of the organization and its members.

Along with changing how we do business, we also have to bring the organization into the future with our technology infrastructure. The NAEA website leaves a lot to be desired, as well as some of our automated processes. The goal right now is to launch a new and improved website by the end of the calendar year that is mobile-friendly and responsive. This means a great deal of work needs to be completed in order to make this a reality.

Together, we will make NAEA a grEAt organization! In order to accomplish this goal, I will need you to respond to questionnaires, surveys, and polls on a number of topics. The market research we plan to conduct will light the way to our very bright future. EA



CAPITOL CORNER

Be Stubborn about Your Goals …

By Robert Kerr

I just finished my twenty-fifth filing season: ten at IRS, two on the Hill, and thirteen here at NAEA's intergalactic headquarters, where I have been privileged to advocate for a great group of professionals. My accomplishment is a relative one, admittedly. I file one tax return a year—some say ill-advisedly (though often with the advice of my EA, whom I thank here anonymously)—and many of our members have significantly more filing seasons under their belts, so I'm not suggesting equivalency.

The single constant though has been how fluid the environment is and how much we rely on tax professionals to maintain their essential integrity while adapting to the times.

NAEA has not stood still either; we evolve with the times and find new ways to engage with members and to advocate here in Washington (and to support those advocating at the state level). Earlier this year, we hosted our eighth annual Fly-In Day and focused on IRS's proposed SEE user fee increase; taxpayer representation in IRS Future State; and minimum standards for return preparers.

Faithful readers will know we've jumped up and down and lit our hair on fire (figuratively, of course) on all three, each of which is significant to the profession (see the "Advocacy" section of NAEA.org for correspondence on the issues).

With the help of our member advocates, we have a victory to share: a congressional letter to IRS focused on the proposed SEE user fee increase. The details are available on our website, but the high points are here:

> The IRS has consistently sought to implement minimum standards for return preparers, and should be encouraging qualified professionals to pursue the EA credential as a common-sense next step. We do not believe increasing the cost of the SEE, and by such a substantial amount, in any way encourages aspiring tax professionals to take this next step. The EA credential ultimately serves to benefit general tax administration and the public at large …

The letter goes on to ask for details about the proposed user fee increase and asks IRS to delay implementation of the fee increase. We are at least somewhat optimistic IRS will reveal to members of the House Ways and Means Committee (five of them signed the letter) why the agency needs a dozen more staff to oversee a program implemented by a private sector firm for less money, as well as why the agency needs to charge the user fee in the first place.

Dr. Charles Boustany, who sits on the House Ways and Means Committee and is the former chair of the committee's IRS Oversight Subcommittee, took the lead on the letter, which is signed by eight House members.

We couldn't be more pleased—and we couldn't have done it without the grassroots push from our Fly-in Day attendees.

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Speaking of evolving with the times, NAEA instructors are leading two great courses at the 2016 IRS Nationwide Tax Forums. One focuses on charitable contributions—an evergreen topic if ever there was one—while the other focuses on the so-called shared economy, which is exemplified by online transportation services (*e.g.*, Uber and Lyft) and the online home rental services (*e.g.*, Airbnb and HomeAway).

In his keynote speech, Commissioner Koskinen mentioned only one of the 40+ classes offered at the forum: a shared economy course. He also put in a nice plug for enrolled agents, suggesting tax professionals take the additional time and effort necessary to become enrolled agents. He shared what we already know—that the ability to represent is valuable to both taxpayers and the IRS.

About the Author

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

In the same vein, Return Preparer Office Director Carol Campbell threw EAs a huge bouquet in her RPO overview course. She characterized EAs as holding "an elite credential" and went on to exhort the crowd by saying, "There's no reason to prepare returns year in and year out and not be recognized as a tax pro." She identified, correctly in my humble opinion, the importance of unlimited practice rights. She challenged preparers to "get the credential that supports what you do."

Given the generous pushes from Koskinen and Campbell, plus NAEA's strong presence in the exhibit hall, the forums are shaping up to be great news for enrolled agents and NAEA.

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One more item from the tax forums: Enrolled agents and certified public accountants have been asked to sit on the Office of Professional Responsibility panel focused on conflicts of interest. OPR Director Steve Whitlock reached out to NAEA and AICPA for panelists, which seems only reasonable, wouldn't you agree?

I had the opportunity to pinch hit for Frank Degen, EA, USTCP, at the Chicago forum. I opened with a line I've heard Frank use on multiple occasions (no, not the Learned Hand quote on taxes): "Frank likes to say that he taught me everything *I* know about taxes, just not everything *he* knows about taxes."

The panel was interesting because it focused on ethics, in this case conflicts of interest, which are addressed in Circular 230 Sec. 10.29. This section prohibits representation in circumstances in which a conflict of interest exists. We all know that (or I hope we all know that!). What I find most interesting is the exception: a practitioner may represent a client if: the practitioner reasonably believes (s)he will be able to provide competent and diligent representation to each affected client; the representation is not prohibited by law; and each affected client waives the conflict and gives informed, written consent.

I wonder whether our members revisit Circ. 230 Sec. 10.29 often enough and think about it in the common context of running a practice, for instance: spouses; partners within a partnership; a partnership as an entity and partners as individual entities; and former clients.

Finally, we drew a number of common-sense, but important, conclusions: (1) always use an engagement letter; (2) never go without E&O insurance (really, there's simply no valid excuse); and (3) some potential clients you cannot charge enough.

Item three reminded me of long-time NYSSEA member Norman Barotz, EA, who is fond of advising SWAN, which is the acronym for "sleep well at night." As much as the tax environment changes, we always need to assess our ethical responsibilities and ask ourselves whether we truly want a client.

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And I would be remiss if I did not address one more advocacy item—IRS Future State. The agency wants to reassess how it provides service in the twenty-first century and in a severely resource-constrained environment. It would like to move as many transactions as possible online so that taxpayers can serve themselves. I get that—lots of people are comfortable helping themselves online and do not want (or do not believe they need) representation.

We remain concerned, however, about the Service's commitment to representation, which remains a fundamental taxpayer right. National Taxpayer Advocate Nina Olson concluded, "I continue to be concerned that the IRS's design for the Future State ignores or dismisses the significant body of data that shows large portions of the taxpaying public [are] either unable or unwilling to engage with government online services for anything other than the most routine tasks, if those."

NAEA has weighed in with individual tax writers and is advocating for legislative language that requires the Service to create an electronic signature standard for the Form 2848 (Power of Attorney and Declaration of Representative) and Form 8821 (Tax Information Authorization). We remain concerned IRS's approach will hand the keys to the Tesla to individual taxpayers and leave representatives in their Conestoga wagons.

As NAEA testified at one of Olson's hearings, "As IRS moves forward with online accounts … it must include access by those with unrestricted rights to represent taxpayers."

We went on to remind the Service:

> A solution that omits practitioners fails to recognize that many taxpayers benefit from representation because they (a) do not want to represent themselves; (b) recognize they are not proficient enough to represent themselves; or (c) are afraid to engage with IRS enforcement staff.

*****

The environment enrolled agents operate in is fluid, and we must be aware of changes and be willing to adapt. When we have a goal—providing quality, ethical advice and service for individual enrolled agents and defending the profession for NAEA—we are much better able to adapt.

We are all well-served when we are stubborn about our goals but flexible about our methods. And I know NAEA is making progress toward its goals when leaders at IRS make a point of promoting the agency's elite credential, when influential members of Congress weigh in on SEE user fees, and when we continue to fight for our profession. **EA**

HOW TO MAXIMIZE PENALTY RELIEF FOR YOUR CLIENTS

By Jim Coleman, EA

There are a number of ways delinquent taxpayers (your clients) can potentially reduce their overall debt to the IRS. There is the offer in compromise (OIC), that oft-dangled carrot and so-called "pennies on the dollar" settlement that many tax resolution firms pitch to lure negligent taxpayers to their companies. There is the innocent spouse resolution that can prevent one member of a marriage from being liable for a tax debt caused by his or her "better half." Taxpayers who have been assessed additional tax, penalties, and interest can request an audit reconsideration, which could possibly lower or eliminate their balance altogether if the assessments are determined to be erroneous or in excess of the correct tax liability.

Any or all of these possible solutions may sound promising in theory, but in practice are anything but. Only a small percentage of taxpayers—primarily those with little income and without assets, such as a home—are accepted by the IRS for an OIC. Those who attempt to separate themselves from a tax liability by qualifying as an innocent spouse often have a difficult time proving that they had no knowledge of, or responsibility for, their spouse's underpaid taxes or unreported income, and are subsequently denied relief. An audit reconsideration requires sufficient evidence to support a taxpayer's position, and the final determination is left entirely to the discretion of the IRS.

The most conventional way delinquent taxpayers can reduce their debt is to establish a payment plan with the IRS for their tax/penalty/interest liability—or pay the entire amount due—and then submit a request for penalty abatement. Many taxpayers believe the IRS has little incentive to refund penalty assessments once they have been paid, but in actuality the IRS has no problem issuing a penalty refund check to a taxpayer if convinced the taxpayer has a legitimate argument for penalty relief.

There are essentially three phases to a penalty abatement case:

- First-time abatement, in which a taxpayer's compliance record determines how much penalty relief can be obtained.
- Reasonable cause penalty abatement at the IRS service center level, where a software program known as the Reasonable Cause Assistant (RCA) generally determines whether a taxpayer qualifies for penalty relief.
- Reasonable cause penalty abatement at the IRS Office of Appeals level, where a taxpayer's representative has an opportunity to argue the merits of the client's case during one or more conferences with an appeals officer or appeals tax specialist, and perhaps a group manager, as well.

Although taxpayers can go beyond the IRS and appeal their case to the U.S. District Court or Claims Court, most taxpayers or their representatives generally do not attempt this additional step. Knowing how to squeeze the most penalty relief out of each of the aforementioned phases could significantly reduce your client's overall debt to the IRS.

First-Time Abatement

First-time abatement (FTA) is a one-time administrative waiver of failure to file/failure to pay penalties assessed against individual income (1040) taxes, or failure to file/failure to pay/failure to deposit penalties that have been assessed against any of the following federal business taxes: employment (941, 944), unemployment (940), corporation and partnership income (1120, 1065), and excise (2290, 720) taxes.

The FTA process is explained in Sec. 20.1.1.3.6.1 of the Internal Revenue Manual. FTA is sometimes referred to as "low-hanging fruit" because: (1) this method of penalty abatement is the simplest and can often be requested and

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received with one phone call to the IRS's Practitioner Priority Service, and (2) because you and your client do not have to prove to the IRS that there was reasonable cause for the tax issue in question; penalty relief is granted solely on the basis of your client's compliance history for a given tax.

There are several limitations to FTA, however. It can only be received once for each type of qualifying tax, and only for one tax period. Your clients cannot simply pick and choose the tax periods they want penalties removed from. There are also several compliance and statute criteria that must be met before FTA will be granted, and once it is, your clients can never again receive FTA for that type of tax.

To qualify for FTA for a particular tax period, your clients must meet the following compliance criteria. First, they must have a "clean" taxpaying/tax return filing record (no failure to file/failure to pay/failure to deposit penalties of $1.00 or more) for that type of tax in the three years preceding the tax period for which they are requesting FTA. Although failure to prepay (estimated tax) penalties, accuracy-related penalties, fraud penalties, civil penalties, or bad check penalties are not eligible for FTA, they will not disqualify your clients from receiving FTA if one or more of them has been assessed against the same tax period for which FTA has been requested.

Second, your clients must have either paid the full balance due for that type of tax or have established a payment plan with the IRS that is in good standing.

Third, your clients must have filed all returns for that type of tax for the past three years, as required.

You must also make the request for FTA (or for *any* type of penalty abatement, for that matter) prior to the expiration of the IRS statute of limitations for receiving a penalty refund/credit if you hope to receive relief for your clients. The statute period is the later of the following: (1) within two years of the date that the balance was paid on the requested tax period; or (2) within three years (including filing extensions) of the date that the tax return was due to be filed for the requested tax period. If a tax period still has a balance that has not been paid or written off by the IRS, that tax period—no matter how old—still has the potential to qualify for FTA, provided it meets the aforementioned compliance criteria.

A simple investigation of your clients' IRS account transcripts for a given tax should tell you whether they qualify for FTA based on both the compliance and statute criteria.

Reasonable Cause Penalty Abatement at the IRS Service Center Level

Once the FTA option has been exhausted, you can still attempt to recover failure to file, failure to pay, failure to deposit, accuracy, civil and failure to prepay penalty assessments from the IRS by submitting a written request for penalty relief based on reasonable cause criteria. Sec. 6651 of the Internal Revenue Code (IRC) imposes penalties for failing to timely file and/or pay one's taxes. The section also notes that such penalties are exempted if it is shown that your client's failure to file or pay was "due to reasonable cause and not due to willful neglect." IRC Sec. 6651 is thus an invitation for taxpayer excuses of why he or she failed to timely file tax returns and/or that timely pay taxes.

The first step in establishing reasonable cause is to determine what occurred. To accomplish this, you will need to interview your client and get a thorough explanation of what caused the tax issue before concluding whether there was reasonable cause for the tax problem.

Ultimately, the decision of whether penalty relief will be granted is made by an IRS service center representative, who will consider the facts and circumstances listed in your written penalty abatement request and enter the data into the RCA, a custom computer software program that generally determines if the IRS's definition of reasonable cause has been met. The best chance your clients have of establishing reasonable cause for penalty relief is to demonstrate to the IRS that, despite exercising ordinary business care and prudence, circumstances beyond their control prevented them from timely meeting their federal tax obligations.

Over the years, the IRS has reviewed—and rejected—thousands of explanations for why taxpayers believe they should qualify for penalty relief. There are U.S. Tax Court cases on record in which taxpayers have claimed their divorce, their alcoholism and/or drug addiction, their workload, their back pain, their religious beliefs, their ethnicity, the fact that they were single mothers, the fact that they were accountants too busy preparing *other* people's tax returns, etc., as reasons for not timely meeting their federal tax responsibilities.

Here are some examples of circumstances that *do* fit the reasonable cause criteria for failing to timely file a tax return or timely pay taxes:

- Natural or man-made disasters, such as hurricanes, fires, floods, earthquakes, tornadoes or other catastrophic events—especially if the government declares an area a federal disaster zone.
- A taxpayer's death, serious illness, incapacitation, or unavoidable absence.
- A taxpayer's inability to obtain records necessary to accurately assess his/her tax liability or prepare a tax return.
- Tax preparer errors.
- Bookkeeper/accountant fraud or embezzlement of funds.
- Erroneous oral or written instructions or advice furnished by IRS officers and representatives acting in their official capacity.

Failure to Pay
A lack of funds is generally not considered reasonable cause for failing to pay taxes to the IRS. However, you can make a case for penalty abatement on the grounds of financial hardship if you can demonstrate that your client "exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship if he paid on the due date."[1] In other words, you need to demonstrate *why* your client did not have the funds to pay the taxes (*e.g.*, disaster, death, illness, etc.).

Failure to File
A lack of funds is never a valid excuse for failing to timely file a federal tax return. The IRS makes it clear that there is a distinction between being unable to pay taxes and being unable to file a tax return. This is why failure-to-file penalties are perhaps the most difficult to get abated, because it takes much more than simply telling the IRS that your client did not have the funds necessary to pay his/her tax liability, and, therefore, did not timely file the corresponding tax return.

Failure to Deposit
Another difficult assessment to remove via reasonable cause is the failure to deposit penalty (also known as a federal tax deposit penalty), which is imposed on businesses that neglect to timely submit the trust fund portion of their employees' withholding taxes following each payroll period. The IRS does not take kindly to business taxpayers who take these funds and use them for their own purposes instead of rightfully depositing them with the federal government. To recover or reduce failure to deposit penalties based on a lack of funds, you need to show that the financial hardship was more than a mere inconvenience to your clients. You also

"THE IRS MAKES IT CLEAR THAT THERE IS A DISTINCTION BETWEEN BEING UNABLE TO PAY TAXES AND BEING UNABLE TO FILE A TAX RETURN."

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need to show that they exercised ordinary business care and prudence during the economic crisis by reducing salaries, laying off staff, eliminating bonuses and benefits, and taking other measures that lowered the company's operating costs during the difficult financial periods.

Accuracy-related infractions, such as the penalty for substantial understatement of income tax (IRC Sec. 6662(d)), are imposed following an IRS examination of a tax return when it is determined that your client failed to report the correct amount of tax on a return. Accuracy penalties are best overcome during the abatement process by citing the exception listed in IRC Sec. 6664(c), which provides that no penalty be imposed under Sec. 6662 for any portion of understatement of tax for which your clients show that there was reasonable cause and they acted in good faith. Generally, the most important factor is to demonstrate the effort your clients put into determining their proper tax liability, including any reliance on professional tax advice in making that determination.[2]

In addition to providing the IRS with the facts and circumstances that prevented your clients from timely tending to their tax obligations, you will need to submit documentation to support the argument for penalty relief. As compelling as your narrative may be, the IRS will not simply accept your claims as the truth. If your clients' tax issues were the result of a health condition or death, you should include the medical records and/or a signed letter from a doctor confirming the illness, period of treatment, surgeries, and any injuries or symptoms that may have affected your clients' ability to file/pay their taxes. If the tax liability/penalty assessments occurred due to a lack of funds, include your clients' bank statements for the tax periods at issue to confirm the financial hardship. If the tax problem was caused by a theft or embezzlement of funds from a business, provide the IRS with a police report of the crime and/or a copy of any claim filed with a court against the alleged perpetrator.

The final penalty abatement package should include: the tax periods at issue; a statement of the facts and circumstances that resulted in the tax liability/penalty assessments; a summary of the penalties to be removed; a summary of the support documentation provided and copies of the exhibits themselves; a copy of your Form 2848 (Power of Attorney and Declaration of Representative) to act on behalf of your client; and a signed declaration attesting, under penalty of perjury, that the facts stated in the penalty abatement request are true and correct to the best of your and your client's knowledge.

The package should be mailed to one of three IRS service centers: the Ogden campus in Utah; the Cincinnati campus in Ohio; or the Covington campus in Kentucky, which will route the taxpayer's written request for penalty abatement to the Cincinnati office. You will generally receive a penalty abatement determination from the service center in two to three months.

Reasonable Cause Penalty Abatement at the IRS Office of Appeals Level

Any tax periods that are denied penalty relief by the IRS service center may be resubmitted to the IRS Office of Appeals for penalty abatement consideration. The Office of Appeals is an independent organization within the IRS that resolves various types of taxpayer disputes with the federal government, including cases in which a taxpayer has been denied penalty relief by an IRS service center or revenue officer. When cases reach the Office of Appeals, appeals officers or appeals tax specialists (specialists) are assigned to determine whether there is reasonable cause for penalty abatement. The specialists review all submitted materials and documentation and check your clients' history of compliance with IRS tax codes and regulations.

The final penalty appeal package should include all the elements of the penalty abatement package that was sent to the IRS service center, with one addition: copies of the notices your client received from the IRS denying the original request for penalty relief. The notices include instructions for submitting an appeal and indicate which office the appeal package should be addressed to—either the Ogden, Utah appeals campus or the Covington, Kentucky, branch—and confirm that your initial attempt at penalty removal was unsuccessful.

Penalty abatement based on reasonable cause criteria is not the quick fix many taxpayers hope it will be, especially during the appeals process. Once a penalty appeal (sometimes referred to as a "protest") is submitted to the Office of Appeals, it generally takes several months for the case to be assigned to a specialist, and another couple of months for the specialist to review the materials and render a preliminary response. Once you or your client receive the specialist's response, you may schedule a conference with the specialist to discuss the merits of your client's case. The conferences are generally conducted over the telephone rather than face to face, and you may include your clients in the conferences if you believe they might be helpful in clarifying specific points or explaining why the tax issues developed in the first place.

If your client's penalty appeal spans multiple tax years or tax periods, it is best to focus during the conference on those time frames or specific penalty assessments for which there is credible evidence and documentation to support reasonable cause for the tax issue.

In the end, it will be the specialists, with guidance from their managers, who will determine whether your clients deserve to receive penalty relief. Appeals tax specialists' temperaments can vary considerably. Just as with any large business, the IRS Office of Appeals employs amicable and accommodating specialists who are receptive to taxpayers' issues and willing to consider a settlement. However, there are also inflexible, uncompromising specialists who seem to have their minds made up before negotiations ever begin, and who cannot be budged from their intent to sustain all the taxpayers' penalty assessments.

If you encounter a particularly difficult specialist unwilling to accommodate, you can always ask to speak to the specialist's supervisor/group manager who, upon hearing the facts of the case, may or may not render some penalty relief. In either case, it behooves you to keep your cool during these conferences—especially if you regularly do business with the Office of Appeals—because there is a good chance you will work with many of the same specialists again in the future.

The Last Resort

Even if a request for penalty relief is denied by both the IRS Service Center and the Office of Appeals, your clients have additional appeal rights in court. To pursue further appeal of any tax period that has been denied penalty relief by the Office of Appeals, you must complete a separate Form 843 (Claim for Refund and Request for Abatement) for each tax period you wish to appeal. The tax period's penalty balance must be paid prior to submitting a Form 843 claim for refund to the IRS. Once you receive a Form 843 refund denial notice from the IRS for a given tax period, you have a two-year window to file a claim for penalty relief for that tax period with the U.S. District Court or U.S. Claims Court. Go to www.irs.gov for additional information on how and where to file Form 843 with the IRS. EA

About the Author

Jim Coleman, EA, is a penalty abatement specialist at Tax Guard in Boulder, Colorado. He represents businesses nationwide before the IRS's Collection and Appeals Divisions with respect to their penalty abatement cases.

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

ENDNOTES

1. Treasury Department Code of Federal Regulations Sec. 301.6651-1(c)(1)
2. Treasury Department Code of Federal Regulations Sec. 1.6664-4(b)(1)

THE UNCANNY

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I used to work in a Loew's Theatre in California during the days of Flower Power, the draft, and the advent of the eighteen-year-old vote. Back then, movie theatres sold cigarettes and other tobacco products. After all, Loews owned the Lorillard Tobacco Company. At the time, word on the street was that Lorillard had trademarked several brand names for marijuana cigarettes, though you can't find any evidence of that today. We were all very excited about the prospect of legalizing marijuana, thinking our generation had invented the concept. But the history of marijuana legalization is much longer than you can imagine.

BY EVA ROSENBERG, EA

THE UNCANNY

CANNABIS CONTROVERSY

The Two Main Legal Marijuana Businesses in the United States

Marijuana sales are smoking! Billions of dollars are being generated nationwide in legal businesses, which means tax collections are rising in states that have legalized marijuana. As of June 8, 2016, twenty-five states and the District of Columbia have legalized medical marijuana use, with a variety of possession limits.[1] Four states have legalized recreational marijuana sales,[2] though the District of Columbia law is limited to possession.

... THERE ARE SOME UNIQUE PROBLEMS AND FINANCIAL ISSUES FACED BY LEGAL MARIJUANA BUSINESSES THAT OTHER BUSINESSES DON'T HAVE.

There are two legal types of sales, depending on the state: medical marijuana only and recreational and medical marijuana.

Naturally, there are several different ways to configure each of the businesses; the structures are limited only by the imagination. Here are just a few ways cannabis is being sold:

- head shops that sell primarily pot and related supplies
- centers that offer medical counseling, pot sales, supplies, courses, books, clothing, etc.
- social lounges and smoking clubs (consume on the premises with munchies and tools—free or paid)
- growing supplies and classes
- growers who sell to distributors or co-ops
- co-ops that grow their own product
- distributors

The Primary Legal Issues

The primary focus for our discussion is the federal tax issues, so we will look at the current state of federal tax laws as they affect our clients. As far as the states go, if a state has legalized all marijuana businesses, those tax returns will be the same as for any business. If a state has only legalized medical marijuana, and the business only deals in medical marijuana, again, the state tax issues will be the same as for any business. But there will be a distinct difference between federal and state reporting. And there are some unique problems and financial issues faced by legal marijuana businesses that other businesses don't have.

We will address those as we go along. Sec. 280E states:[3]

> No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of Schedule I and II of the Controlled Substances Act) which is prohibited by federal law *or* the law of any state in which such trade or business is conducted.

Under Explanation of Provision, the Senate report related to this code section reads as follows:

> All deductions and credits for amounts paid or incurred in the illegal trafficking in drugs listed in the Controlled Substances Act are disallowed. To preclude possible challenges on constitutional grounds, the adjustment to gross receipts with respect to effective costs of goods sold is not affected by this provision of the bill. Conf. Rep. No. 97-760 at 598(1982) and 1982-2 C.B. 661

For the most part, the enforcement pressure is off for licensed medical marijuana purveyors, but not for recreational dealers.

Bottom line? Federal law enforcement resources are limited. They are not seeking to actively pursue medical marijuana establishments that are in compliance with state laws. And the IRS's position is that it will not bring action against tax professionals who work with or represent taxpayers who are in legal compliance with state laws. However, when it comes to the deductibility of expenses in businesses that are still considered illegal on the federal level, those deductions will remain limited.

The Banking Issues

The Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury has agreed not to go after state-licensed medical marijuana businesses.[4] However, the FDIC essentially, and subtly, threatened to pull all insurance coverage from banks that service such businesses … or anyone related to them.[5] Their position is that if the banks cooperate with these marijuana businesses, the banks are aiding and abetting criminal activities in the form of drug trafficking.

As a result, it is virtually impossible for those who own marijuana businesses to open bank accounts or merchant credit card accounts with U.S. banks, particularly any bank that is insured by the FDIC. This means that marijuana businesses are forced to operate purely via cash transactions.

What problems does that create? Many. First of all, the businesses have very high costs for security. With all that cash around, they are prime targets for theft. Yet, the cost of security is not deductible on a federal tax return.

Then there is the issue of what to do with that money. Andrew Ittelman, founding partner of Fuerst Ittleman David & Joseph, PL, is a banking industry consultant whose practice focuses on white-collar criminal defense, anti-money laundering compliance and food and drug law. In an interview, Ittelman described tactics of some cannabis operations to deal with the cash. They chartered airplanes to take the cash to offshore banks where their funds could be deposited. Again, these costs are not deductible on a federal tax return.

These businesses have employees and try to be in compliance in regard to putting staff on payroll. But no bank account means the business has no place to make federal payroll tax deposits. What does the company do? The marijuana businesses come into the IRS office with bags of cash, and hopefully, a security guard/armored truck. However, currently, the IRS has a policy of assessing a penalty of 10 percent when taxpayers do not pay their payroll taxes electronically.

That seems totally unreasonable, doesn't it? That's what the owners of Denver-based Allgreens, LLC, a medical-marijuana dispensary that challenged the agency over its policy, thought, too. So in June 2014, the company filed a Tax Court petition to get its penalties abated.[6] Although the case was docketed for November 2015, the IRS settled in March 2015[7] to avoid setting a precedent (and the case was removed from the Tax Court docket on July 16, 2015, due to "mootness"[8]).

However, in the settlement with Allgreens, IRS said it would abate future penalties and will refund approximately $25,000 of fines the business was forced to pay despite having paid its federal employment withholding on time.

Essentially, the IRS's position now is if a business is legal in the state and cannot get banking due to banking restrictions, it will waive the 10 percent penalty. On July 17, 2015, the IRS updated the Internal Revenue Manual to add this provision to 20.1.4.26.1, Unbanked Taxpayers:[9]

> Payments made directly to the IRS can result in a failure to deposit penalty assessed at the 10 percent rate. See IRM 20.1.4.26.1.1 Unbanked Taxpayers for penalty relief for unbanked taxpayers.

That brings us to IRM 20.1.4.26.1.[10] Use the general penalty relief guidelines to file claims for refunds on clients/businesses that were affected. You can reference the IRM Code Sec. 20.1.4.26.1 as the basis for recouping those penalties. Remember, the IRS can only issue refunds for up to two years after payment. So, time may be of the essence.

If you have clients operating in this industry who need banking and financial resources, the *Marijuana Business Daily* has a directory of resources, including banking and loans at https://mjbizdaily.com/industry-directory.

Another banking issue that arises is that of related businesses. Due to the FDIC's tough stance on dealing with marijuana businesses, banks are also concerned about associated businesses. What are associated businesses?

- banks
- landlords
- insurance
- testing
- security
- hydroponics industries, *e.g.*, lighting, soil, fertilizers, irrigation, power management, utilities
- attorneys, accountants, consultants
- non-pot vendors (advertising, packaging and supplies, and staff training)

For instance, a realtor reported that his client's lender called the loan on a building when the bank learned the tenant was selling marijuana. The landlord did not want to evict the tenant because the tenant was paying double the going rate for rent—and paying it all in cash. The landlord's only alternative was to seek private financing. As a result, the interest rate on his loan jumped about 70 percent—from 5 percent with the bank to 8.5 percent with a private lender.

Watch out for similar repercussions from your bank since you are an associated business. Generally, the banks do not seek out these issues, but when a concerned citizen reports a case to them, they are forced to investigate the complaints.

Will any of this change? The Marijuana Businesses Access to Banking Act of 2015 was introduced in Congress on April 28, 2015[11] and to the Senate as S.1726 on July 9, 2015. The purpose:

> This bill provides a safe harbor for depository institutions providing financial services to a marijuana-related legitimate business insofar as it prohibits a federal banking regulator from: (1) terminating or limiting the deposit or share insurance of a depository institution solely because it provides financial services to a marijuana-related legitimate business; or (2) prohibiting, penalizing, or otherwise discouraging a depository institution from offering such services.

Additionally, the Merkley-Murray Marijuana Banking Amendment[12] passed the Senate Appropriations Committee on June 16, 2016. Perhaps this is just the beginning of making banking available to state-legal cannabis operations. And so we wait …

The Impact on Federal Tax Returns

We need to cover several issues here:

- cash versus accrual accounting and cost of goods sold (COGS) and inventory
- deductibility of sales and excise taxes
- allocating expenses between the

(federal) legal business and the state-only legal business

Cash Versus Accrual for Inventory-Based Businesses

IRC Sec. 471[13] states that when required to use an inventory method, a taxpayer also is required to use an accrual method for purchases and sales of merchandise. (See Sections 1.471-1,[14] 1.446-1(c)(2)(i),[15] and also Sec. 1.61-4(b).)[16] Thus, the taxpayer will capitalize inventoriable costs when incurred and will remove these costs from inventory when units of merchandise are sold. Stated differently, the taxpayer will compute COGS as an adjustment to gross receipts.

The rule that applies to farmers (as in cannabis growers) is different from the rule that applies to producers and resellers. A farmer using an overall accrual method also must use an inventory method because of its use of an accrual method.

Similarly, a cash-method producer or farmer will deduct production expenses from gross income in the taxable year paid and, thus, will have no basis in the merchandise that it eventually sells. In the case of a cash-method reseller, producer, or farmer, the obligation to pay income tax on gains derived from the sale of a controlled substance creates tension between the accepted interpretation of "income" under the Sixteenth Amendment and Sec. 280E, which disallows all deductions of a trade or business trafficking in a Schedule I or Schedule II controlled substance.

Under the modified cash method as described in Rev. Proc. 2001-10[17] and Rev. Proc. 2002-28,[18] a reseller may account for merchandise as "inventories" or as "materials and supplies that are not incidental." (See Sec.1.162-3 (a)(1).)[19] When a unit of merchandise is sold, the reseller will account for that cost as a deduction from gross income in the taxable year that the unit is sold or the payment is received, whichever is later. Note: Certain taxpayers with inventory are exempt from the accrual method:[20]

- A qualifying taxpayer under Rev. Proc. 2001-10 in Internal Revenue Bulletin 2001-2. (Gross receipts of $1 million or less)
- A qualifying small business taxpayer under Rev. Proc. 2002-28 in Internal Revenue Bulletin 2002-18. (Average gross receipts for three years are more than $1 million, but not more than $10 million.)

Four years after enacting Sec. 280E, Congress enacted the Tax Reform Act of 1986, which added the uniform capitalization rules of Sec. 263A[21] to the Code. Under Sec. 263A(a), resellers and producers of merchandise are required to treat as inventoriable costs the direct costs of property purchased or produced, respectively, and a proper share of those indirect costs that are allocable (in whole or in part) to that property.

Flush language at the end of Sec. 263A(a)(2) states:

> Any cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.

For example, the portion of a taxpayer's interest expense that is allocable to personal loans, and hence is disallowed under Sec. 163(h), may not be included in a capital or inventory account and recovered through depreciation or amortization deductions, as a cost of sales, or in any other manner. In other words, normal Sec. 263A capitalized costs, like payroll, rent, and overhead, cannot be added to inventory for sales of prohibited products.

Does the IRS have the right to change your inventory method? Yes. If someone is required to use an accrual method, the IRS can insist on a change. However, if the individual meets the $1 million or $10 million small business exclusion, the IRS may not.[22]

Why do we care about all this tedious information? Because our goal is to provide our clients with the highest allowable expenses for their federal tax deductions. Understanding how to use (and not use) the inventory and accrual rules can be quite beneficial. This is critical because although the IRS does not allow deductions for operating costs, both the IRS and the state do allow deductions for actual inventory costs—whether on cash or accrual.

Routine inventory costs include the cost of the product, packaging, and freight in. They also include any cost of securely bringing the freight into the facility, all production costs directly related to converting the raw product (raw material) to a processed product, and labeling. Inventory costs do not include freight out or the cost of shipping to the client.

Will the COGS also include the inevitable employee theft? That's certainly an inventory reduction. Use your best judgment on that determination.

Deductibility of Sales, Excise, and State Income Taxes

In chief counsel advice,[23] IRS has concluded that a business legally selling marijuana under state law can treat the payment of state excise taxes on the production, processing or retail sale of the product as a reduction in the amount realized on the sale. As a result, these taxes are not subject to the deduction bar under Code Sec. 280E.

When it comes to state income taxes, we can use similar logic. Essentially, state

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income taxes are based on a lower net profit than the federal net profit, since the states allow deductions for normal Sec. 162 operating costs. If the states assessed their income taxes based only on the net federally taxable profits, the state income taxes would be significantly higher. As a result, 100 percent of the state income taxes should be deductible.

We are not covering state issues with respect to sales taxes here. However, if you are dealing with clients in your state, it's important to be up-to-date on state issues related to sales taxes.

Allocating Expenses between the Federal Legal Business and the State-Only Legal Business

The good news is that companies with other lines of income can deduct Sec. 162[24] ordinary and necessary business costs associated with those parts of their business. One of the best cases that identifies how to ensure that most of the business' expenses will be deductible is *Californians Helping to Alleviate Medical Problems, Inc. (CHAMP) v. Commissioner of Internal Revenue*, 128 T.C. 173 (2007) (Doc 2007-11902).[25]

CHAMP provided counseling and other caregiving services (collectively, caregiving services) to its members, who were individuals with debilitating diseases (AIDS and cancer). CHAMP also provided its members with medical marijuana pursuant to the California Compassionate Use Act of 1996, codified at California Health & Safety Code Sec. 11362.5 (West Supp. 2007). CHAMP charged its members a membership fee that generally reimbursed CHAMP for its costs of the caregiving services and its costs of the medical marijuana.

Essentially, CHAMP's goal was to break even each year. They structured their membership fees to directly cover all their costs. Although, in the case of CHAMP, this was practically a non-profit operation (wages were low and barely higher than subsistence), the same concept can be applied to a much more profitable organization: Establish a membership, collect dues, and offer related services.

After an audit of CHAMP's 2002 tax return, the IRS determined a $355,056 deficiency in CHAMP's 2002 federal income tax and a $71,011 accuracy-related penalty under Sec. 6662(a). The IRS had disallowed all Sec. 162 costs.

CHAMP filed a Tax Court petition (128 T.C. No. 14):[26]

> The Tax Court's decision held:
> Provision of its caregiving services and its provision of medical marijuana were separate trades or businesses for purposes of IRC Sec. 280E, thus, Sec. 280E, [of the IRC] does not preclude CHAMP from deducting the expenses attributable to the caregiving services.

Following are a few quotes from the Tax Court file and a little more detail about the decision:

> The IRS argues that the "evidence indicates that petitioner's principal purpose was to provide access to marijuana, that petitioner's principal activity was providing access to marijuana, and that the principal service that petitioner provided was access to marijuana ... and that all of petitioner's activities were merely incidental to petitioner's activity of trafficking in marijuana."
>
> We disagree.
>
> As the record reveals, and as we find as a fact, petitioner's management set the total

amount of the membership fees as the amount that management consciously and reasonably judged equaled petitioner's costs of the caregiving services and the costs of the medical marijuana.

Given petitioner's separate trades or businesses, we are required to apportion its overall expenses accordingly.

Accordingly, in a manner that is most consistent with petitioner's breakdown of the disputed expenses, we allocate to petitioner's *caregiving services* 18/25 of the expenses for salaries, wages, payroll taxes, employee benefits, employee development training, meals and entertainment, and parking and tolls (eighteen of petitioner's twenty-five employees did not work directly in petitioner's provision of medical marijuana), all expenses incurred in renting facilities at the church (petitioner did not use the church to any extent to provide medical marijuana), all expenses incurred for "truck and auto" and "laundry and cleaning" (those expenses did not relate to any extent to petitioner's provision of medical marijuana), and nine-tenths of the remaining expenses (90 percent of the square footage of petitioner's main facility was not used in petitioner's provision of medical marijuana).

As you can see, how you structure an accounting system for a marijuana business that provides products or services that are not directly related to the sale of cannabis is important. It is critical to set up an accounting system that classifies each cost, as well as a payroll system that classifies each worker's compensation based on the amount of time he or she spends in marijuana-related activities and other activities. CPA firms routinely use time logs to track billable time in increments of 10–15 minutes—and code the time to various clients' accounts—or as non-billable time, which they abhor. The concept is the same.

IF YOUR CLIENT IS PURELY IN THE POT BUSINESS, YOUR FOCUS WILL BE TO JUSTIFY CLASSIFYING AS MANY COSTS AS POSSIBLE AS COGS.

Obviously, the classification strategy only works for a business that sells other goods or services, not just medical or recreational marijuana. If your client is purely in the pot business, your focus will be to justify classifying as many costs as possible as COGS.

In other cases, the taxpayers lost dramatically. Why? Generally through sheer stupidity and defiance. In *Beck v. Commissioner* (T.C. Memo. 2015-149),[27] the taxpayer was assessed over $1.3 million in income taxes, self-employment taxes, and penalties. Plus, there was interest to be assessed since 2008. Beck objected to the original assessment because it was a form of double taxation. The IRS denied his inventory costs because he had no records (seems he shredded his receipts). Then he was raided by the Drug Enforcement Administration. Beck claimed they seized $600,000 worth of inventory, but he could not prove the amount, nor could he produce records to substantiate the amounts. As in all things tax—legal or illegal—always keep good records!

The Future of Legalization

We await action on the Compassionate Access, Research Expansion, and Respect States Act (CARERS) of 2015. This would transfer marijuana from Schedule I to Schedule II of the Controlled Substances Act.[28] It would amend the Controlled Substances Act to provide that control and enforcement provisions of such Act relating to marijuana shall not apply to any person acting in compliance with state law relating to the production, possession, distribution, dispensation, administration, laboratory testing, or delivery of medical marijuana. Congress has until December 31, 2016, to pass the CARERS Act.[29] Unfortunately, there has been no movement on this bill since its introduction on March 10, 2015. **EA**

About the Author:

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

ENDNOTES

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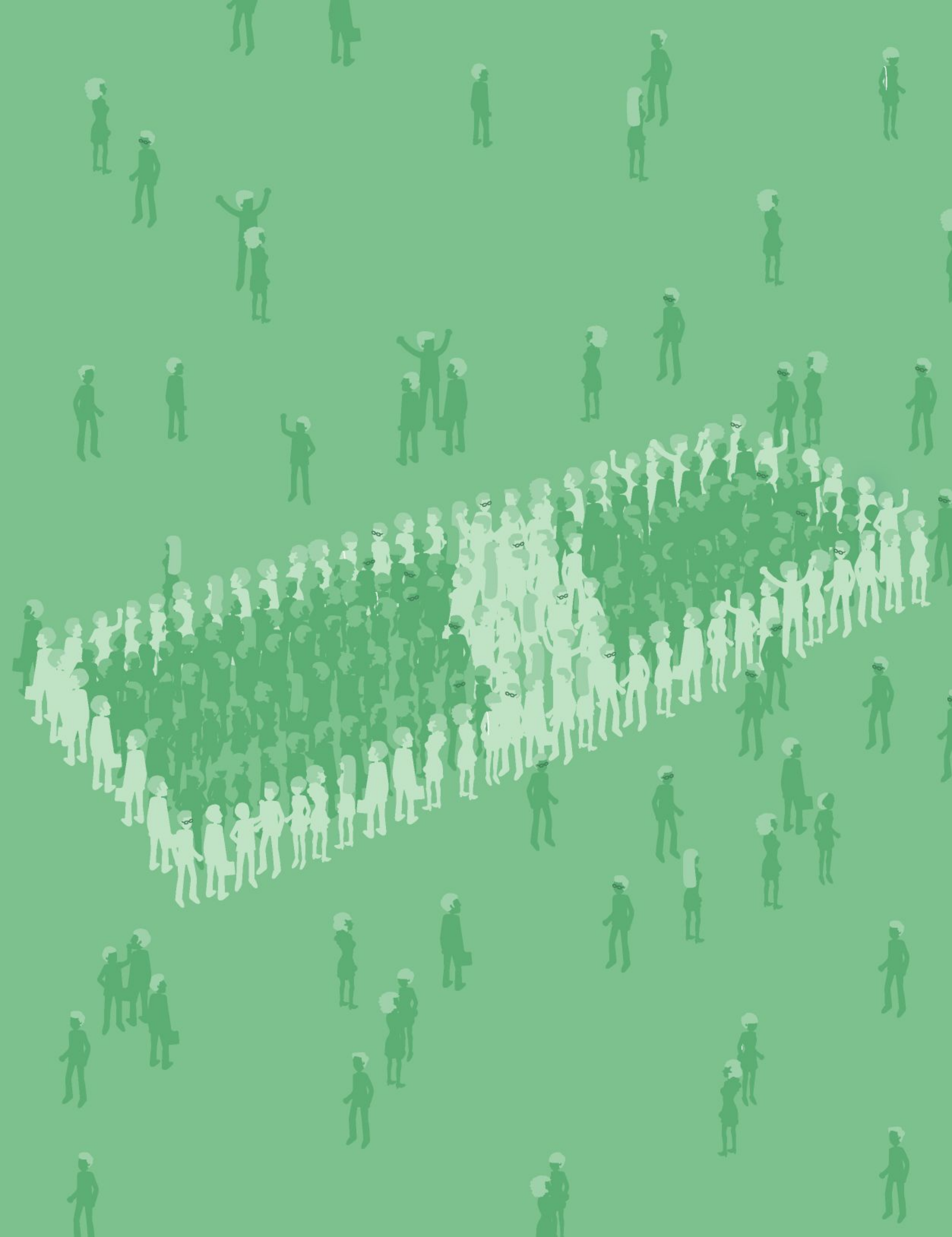


A WORLD OF ALTERNATIVE FUNDRAISING A WORLD OF UNCERTAINTY

BY JEFFREY A. SCHNEIDER, EA

There are many ways our clients seek to get money for their businesses, inventions, or new endeavors. They apply for bank loans, ask family members, dip into personal savings, or in some circumstances, seek the help of venture capitalists. As with most things in life, each option has its plusses and minuses.

But now there is a new kid on the block: crowdfunding. What is crowdfunding? According to Oxford Dictionaries.com, it is defined as "the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the internet."[1] A person or company creates a project that he or she wants help funding, establishing a funding goal and a deadline. Those interested (backers) can give money to the company or project. If the project meets its financial goal, the credit cards of those who pledged will be charged. If the funding goal isn't met, then no one gets charged. Basically, it's all or nothing when it comes to crowdfunding.

There are several websites to help individuals seek investors for their projects (www.kickstarter.com or www.indiegogo.com) or create fundraisers for personal or charitable endeavors (www.gofundme.com or www.causes.com).

But how did crowdfunding get its start? It began in the United Kingdom in 1997 when a rock band solicited financing from its fan base.

The first instance of crowdfunding in the United States happened when ArtistShare was formed in 2001. Eleven years later on April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (JOBS Act), which encouraged "job creation and economic growth by improving access to the public capital markets for emerging growth companies."[2] Most of the provisions of the act have to do with businesses that have dealings with initial public offerings.

The tax implications are still unclear, as the Jobs Act does not actually discuss the taxability of these activities and how the monies they bring in are taxed. For instance, are the monies income, gifts, or capital contributions? Consequently, there are few guidelines, especially when there are many types of transactions and arrangements.

The important question is how do you classify the monies paid for the project? Kickstarter and Indiegogo mention taxes on their sites, but they are very vague in their information. They are not tax advisors, after all, but we are. How do we advise our clients on this matter, especially when we have to take into account other taxes (*e.g.*, sales taxes)?

As with any item of taxation, we must first refer back to our "old friend," IRC Sec. 61,[3] which basically states that all items from whatever sources are included in gross income unless otherwise excluded. An example was just released by the Office of the Chief Counsel of the IRS in PL Ruling 2016-0036[4] on June 24, 2016. The letter, using IRC Sec. 61 as the starting point, states:

> Crowdfunding revenues are generally includible in income if they are not (1) loans that must be repaid, (2) capital contributions to an entity in exchange for an equity interest in the entity, or (3) gifts made out of detached generosity and without any, 'quid pro quo.'
>
> Furthermore:
>
> Voluntary transfers without a 'quid pro quo' are not necessarily a gift for federal income tax purposes.

This latest letter also states crowdfunding revenues must generally be included for services rendered. The chief counsel also refers to Reg. Sec. 1.451-2[5] of the constructive receipt doctrine that includes the stipulation that income is not constructively received if the taxpayer's control of its receipt is subject to restrictions.

The chief counsel closes out the letter stating that crowdfunding taxation "depends on all of the facts and circumstances surrounding that effort."

We, as tried-and-true tax professionals, will have to use our best analytical skills when it comes to determining what platform is used and how it will be handled for tax purposes.

Types of Crowdfunding

So let us discuss the various types of crowdfunding and how taxes are considered.

Equity Crowdfunding

Monies received in this method seem to be like any other equity-based investment. The Security and Exchange Commission has restrictions on who can participate in this type:[6]

- Investors: those who invest in a project for a piece of the pie with hopes to make monies on their capital contributions. It is not unlike investing in any stock via any financial institution. You have basis, you sell (if there is a future market for the equity), and you have a capital gain or loss.
- Company selling the equity—as this is paid-in capital, the taxability associated with it will depend on how the company uses the funds received. Monies taken in have no tax effect. How the company uses the money for expansion, overhead, etc., will determine any deductibility.

Charitable Giving

When monies are donated, the charity has to be an IRS-sanctioned charity. One cannot donate to the "Jeffrey Schneider Needs Money to Replace All He Lost in a Fire" fund and expect to get a deduction, unless the charity has applied for and received approval by the IRS.[7]

In the case of individual givers, if a legitimate charity sets up a platform like crowdfunding to raise money, donors will get a tax deduction when the money is charged to their credit cards. We also have to take into consideration if any goods or services were received in exchange for the donation. If you give a gift to an individual, there may be gift-tax implications.

In the case of charities, it all depends on how the charity uses the money. Receipts used for charitable purposes are not taxable income. However, there can be unrelated business income, which can result in a tax liability for the charity.

For other individuals, if the crowdfunding project was to replace all items lost in a casualty (*e.g.*, fire or hurricane), and the loss was $10,000, what happens to the deductibility if monies were received? Since we are saying that the monies can be construed as a gift, do the monies received reduce the amount of the loss like insurance proceeds? What you do in this situation depends on your and your client's risk tolerance.

Reward Crowdfunding

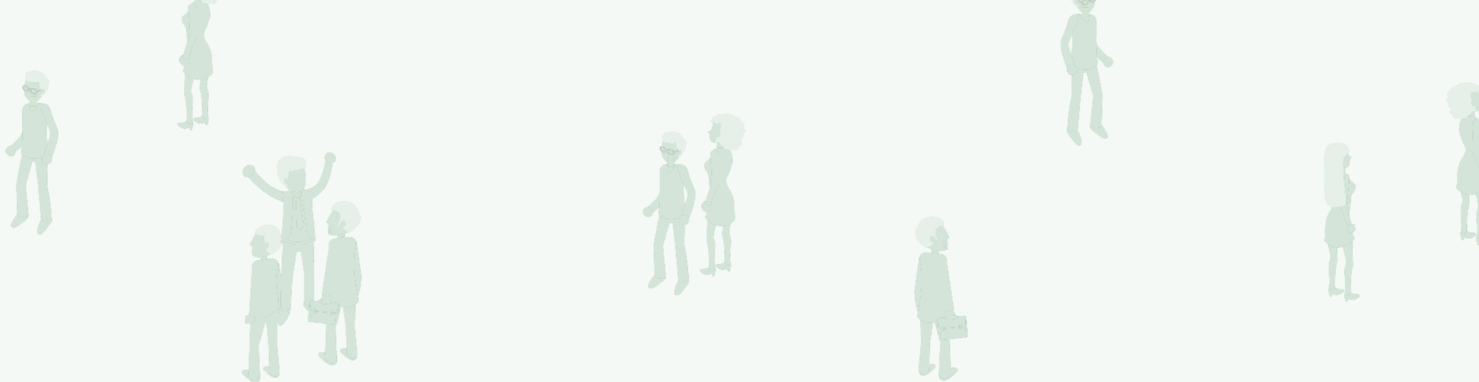
In this type of crowdfunding, a person giving the money gets something other than an equity ownership. When the product that is being funded is finished, the person gets the product or other reward.

For the general public, there is no taxable income as long the value of the "reward" does not exceed the amount paid or given. A question can be raised that if they get something at a greater value than what they paid, could that be taxable income?

For a company, well this is where all the confusion comes into play. As I stated at the beginning, the IRS has been silent on where it is leaning. It will take a court case to decide this issue.

In the case of companies as they relate to income tax, the mainstream thought is that the monies received during this process are taxable income to the company. It is not equity, it is not a donation, so it has to be income, right? But what type of income? As I mentioned, the company is receiving monies in exchange for a promise to reward the individual giving the money. This sounds like a sale of a product.

In regard to sales tax, we have the potential of a sales and use tax liability. Is this any different than when someone buys from Amazon or eBay and the product is out of stock and then shipped at a later date? The person is not billed until the item is shipped. Now, we have out-of-state sales. What state is entitled to the sales tax? Does the company have to register in all the states that the public who registered with this crowdfunding project are in? Or is it similar to internet sales, and only sales tax is collected in the state in which the company is located (nexus[8])?



In the case of a hobby, trade, or business, since we cannot consider the monies provided as a gift under Sec. 61 because a reward is being given,[9] it cannot be a gift. Since there is no equity being provided, then it is not a capital contribution; therefore, it is income. Since it is income, why the worry about it being a trade or business? The deductions can be applied against that income. Deductions in a trade or business are, generally, deductible in the year incurred.[10]

Hobby expenses are limited to the extent of income[11] with other limitations (no losses, no home office deductions, to name a couple). And then we have to worry about start-up costs and their limitations.[12]

In conclusion, all I can say is that I have no conclusion as to how crowdfunding could be taxed for federal, state, or local purposes. I am sure that the IRS is waiting for this to be litigated.

We, as tried-and-true tax professionals, will have to use our best analytical skills when it comes to determining what platform is used and how it will be handled for tax purposes. **EA**

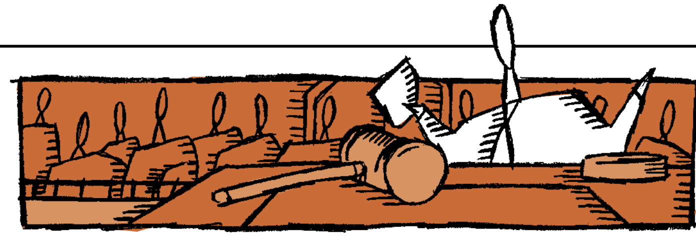
About the Author

Jeffrey A. Schneider, EA, *is the principal of SFS Tax & Accounting Services, Inc. Schneider specializes in tax problem resolution services, as well as tax return preparation for individuals, businesses, and non-profits. E-mail him at jeff@sfstaxacct.com.*

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

ENDNOTES

1. Retrieved from http://www.oxforddictionaries.com/us/definition/american_english/crowdfunding on July 14, 2016
2. See Pub L No. 112-106, 126 Stat 306
3. See https://www.irs.gov/government-entities/indian-tribal-governments/irc-section-61-plr
4. See https://www.irs.gov/pub/irs-wd/16-0036.pdf
5. See https://www.law.cornell.edu/cfr/text/26/1.451-2
6. A discussion on this topic is beyond the scope of this article.
7. See IRC Sec. 170
8. See Pub L No. 86-272
9. Gifts have to be donated by a disinterested party with no expectation of receiving anything in return
10. See IRC Sec. 62
11. See IRC Sec. 183
12. See IRC Sec. 195



TAX COURT CORNER

If the Office of the Clerk of the Tax Court Is Inaccessible, How Is a Time Limitation for Filing a Petition Calculated?

Felix Guralnik, Petitioner

v.

Commissioner of Internal Revenue, Respondent

146 T.C. No. 15

Filed June 2, 2016

By Steven R. Diamond, CPA

The deadline for filing a petition in Tax Court is jurisdictional, which means that the time limit for filing a petition with the Tax Court has been fixed by Congress and, therefore, cannot be extended. However, Tax Court Rule 1(b) provides that if there is no applicable rule of procedure when a unique situation presents itself, the Court may prescribe the procedure by giving particular weight to the Federal Rules of Civil Procedure to the extent they are suitable to determine the matter at hand.

About the Author

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

FACTS

Mr. Guralnik (petitioner) received a Notice of Determination Concerning Collection Action(s) under Sec. 6320 and/or Sec. 6330 that was dated January 16, 2015. The notice sustained the filing of a notice of federal tax lien in respect to outstanding tax liabilities for 2003 and 2005. The notice advised petitioner that he had thirty days from the date of the notice to file a petition if he wanted to dispute the determination in court. The thirtieth day after the date of the notice was Sunday, February 15, 2015. The following day, Monday, February 16, was President's Day, a legal holiday in the District of Columbia. On February 16, the mayor of the District of Columbia announced that a snow emergency would go into effect and that all government

The court went on to point out that neither IRC Sec. 7502 nor Sec. 7503 specifies a comprehensive rule for computing time.

offices in Washington, D.C., including the U.S. Tax Court, would be closed on Tuesday, February 17, due to Winter Storm Octavia. The Tax Court reopened for business on Wednesday, February 18.

Petitioner sent his petition to the Tax Court via Federal Express (FedEx) First Overnight® service in an envelope dated February 13, 2015. While First Overnight service is the most expedited and expensive overnight service offered by FedEx, this service did not exist in 2004 when IRS published its notice designating certain "private delivery services" as meeting the criteria in IRC Sec. 7502(f). In other words, for purposes of the postmark rule, a designated private delivery service would be treated as the equivalent of the U.S. mail; however, FedEx First Overnight service was not a designated service at the time the taxpayer's petition was filed.

The Tax Court does not maintain an after-hours drop box and does not accept papers when the Court is closed. The snow emergency prevented the petition from being delivered on February 17, and the Tax Court at that time did not allow petitions to be filed electronically. Therefore, the petitioner's petition was delivered to the Tax Court and filed on Wednesday, February 18. Since the petitioner could not avail himself of the timely mailed, timely filed rule (FedEx First Overnight service was not at that time on the approved list of private delivery services), the commissioner moved to dismiss the case for lack of jurisdiction.

OPINION

Petitioner argued that the timely mailed, timely filed rule of IRC Sec. 7502 was applicable since it was mailed on February 13, two days before the due date, and was delivered on February 18, a day after the due date. He sent his petition via FedEx First Overnight service. The Tax Court previously held that the timely mailed, timely filed rule does not apply when a taxpayer mails his petition using a non-designated private delivery service.[1] Petitioner argued that those cases were distinguishable because the services that were used were inferior to the premium service listed in the 2004 IRS notice, whereas First Overnight service is more expedited and more expensive than all the services listed in the 2004 IRS notice. The court stated that while this argument had common-sense appeal, it was still not on the IRS-approved list, and since the statute does not authorize the Tax Court to make the designation, it would have to reject the argument.

The petitioner also tried to argue that IRC Sec. 7503 should apply. That code section provides that when the last day for performing any act falls on a Saturday, Sunday, or legal holiday, the performance of the act will be considered timely if it is performed on the next succeeding day which is not a Saturday, Sunday, or legal holiday. On February 17, all D.C. and federal government offices were closed due to a snow emergency. Petitioner contended that February 17 was, as a practical matter, a legal holiday in the District of Columbia. However, the Tax Court did not agree with that line of reasoning as the "snow emergency day" as declared by the mayor is distinct from "legal holidays" under District of Columbia law.

The court went on to point out that neither IRC Sec. 7502 nor Sec. 7503 specifies a comprehensive rule for computing time. IRC Sec. 7503 addresses only one aspect of time computation. It does not address how the first day of a prescribed period should be treated; it does not address how intermediate Saturdays, Sundays, and holidays should be treated; and it does not address how the last day should be treated if extraordinary circumstances make it impossible to file a document or perform an act on that day. IRC Sec. 7502 only addresses the last day for filing, providing that in certain circumstances the postmark date shall be deemed to be the date of delivery.

The Tax Court did, however, acknowledge that the rules of the court do not address how time should be computed when the clerk's office is inaccessible. The clerk's office was inaccessible on Tuesday, February 17, 2015, because of Winter Storm Octavia. Petitions could not be electronically filed that day because the court at that time did not permit electronic filing of petitions. Under Rule 1(b) of the Tax Court it is provided:

> Where in any instance there is no applicable rule of procedure, the court or judge before whom the matter is pending may prescribe the procedure, giving particular weight to the Federal Rules of Civil Procedure to the extent that they are suitably adaptable to govern the matter at hand.

The court, therefore, felt free to apply the principles of the Civil Rules of Procedure, except to the extent that IRC Sec. 7502 and Sec. 7503 explicitly specify a different method for computing time. Neither of those sections precludes the Tax Court from adapting a rule of procedure specifying how time shall be computed when the clerk's office is inaccessible. The court then concluded that it could adapt the rule to compute time when the clerk's office is inaccessible due to inclement weather, government closings, or other reasons. Federal Rules of Civil Procedure Rule 6(a)(3) provides that the time for filing is extended to the first accessible day that is not a Saturday, Sunday, or legal holiday. Since the petition was filed on February 18, 2015, which was the first accessible day after the Tax Court reopened for business, the petition would be deemed timely filed and the court would have jurisdiction to hear the case. The commissioner's motion to dismiss for lack of jurisdiction was denied and the petitioner was able to have his case heard. **EA**

ENDNOTES

[1] *Eichelburg v. Commissioner,* T.C. Memo 2012-258; *Raczkowski v. Commissioner,* T.C. Memo 2007-72

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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 twenty questions.

PENALTY ABATEMENT

1. Which of the following IRS penalties can be removed via the first-time abatement administrative waiver?
A. Failure to deposit
B. Failure to file
C. Failure to prepay
D. All of the above
E. Both A and B

2. The IRS statute of limitations for requesting a refund/credit of penalty assessments is:
A. Within three years of the date that the balance was paid on the requested tax period
B. Within two years (including filing extensions) of the date the tax return was due to be filed for the requested tax period
C. The later of either A or B
D. None of the above

3. The best way to determine if your client qualifies for first-time abatement for a particular type of tax is:
A. Ask the client if he qualifies
B. Order and review the client's IRS account transcripts for that tax
C. Submit a written FTA request to the IRS and hope for the best

4. All of the following could be considered acceptable reasonable cause for failing to timely file a federal tax return except:
A. Hurricane
B. Serious illness or death
C. A lack of funds
D. Erroneous instructions or advice furnished by an IRS representative

5. Which of the following penalties is imposed on business taxpayers for failing to timely submit the trust fund portion of their employees' withholding taxes to the IRS?
A. Failure to prepay
B. Accuracy
C. Failure to file
D. Failure to deposit

6. The IRS will not refund penalty assessments that have already been paid—even if there is reasonable cause to do so and the penalties are within the statute of limitations for receiving a refund.
A. True
B. False

7. The most important factor in overcoming accuracy-related penalties is to demonstrate to the IRS the effort your clients made in determining their proper tax liability, including any reliance on professional tax advice.
A. True
B. False

8. The IRS will not grant first-time penalty abatement unless there is reasonable cause for your client's tax issue.
A. True
B. False

9. Which of the following compliance criteria must be met before a taxpayer can qualify for first-time abatement on a 1040 tax period?
A. Taxpayer must have no failure to file/failure to pay penalties of $1.00 or more in the three years preceding the tax period for which he is requesting FTA
B. Taxpayer must have either paid his full 1040 tax balance or have established a payment plan with the IRS that is in good standing
C. Taxpayer must have filed all 1040 tax returns for the past three years, as required
D. All of the above

10. The IRS Office of Appeals is a taxpayer's last recourse for obtaining federal penalty relief.
A. True
B. False

UNCANNY CANNABIS CONTROVERSY

11. The DEA and other federal agencies have been enjoined from raiding all state-licensed marijuana facilities.
A. True
B. False
C. Only medical marijuana purveyors are so protected

12. The tax code section related to trafficking in controlled substances is:
A. Sec. 162
B. Sec. 179
C. Sec. 263A
D. Sec. 280E

13. Since all marijuana businesses have inventory, they must all report their income and expenses on an accrual basis.
A. True
B. False

14. Which is not an associated business?
A. Landlord
B. Barber who cuts the store owner's hair
C. Label printer for the store
D. Hydroponics supplier

15. What is the IRS penalty for not paying payroll taxes electronically?
A. 2%
B. 5%
C. 10%
D. 15%

16. IRC Sec. 471 states that when required to use an inventory method, a taxpayer also is required to use an accrual method for purchases and sales of merchandise.
A. True
B. False

CROWDFUNDING

17. According to PL Ruling 2016-0036, crowdfunding revenues must generally be included in income for services rendered.
A. True
B. False

18. In reward crowdfunding, if the individual or company that gave the funding received what they paid for, there are no tax consequences.
A. True
B. False

TAX COURT CORNER

19. In the *Guralnik* case, the Tax Court ultimately determined that:
A. The commissioner's motion to dismiss for lack of jurisdiction would be granted
B. Since it was snowing in Washington, D.C., on Tuesday, February 17, 2015, all petitions that taxpayers filed in the month of February would be considered timely
C. If it is snowing in Washington, D.C., on a normal business day, the clerk is required to report for duty
D. The commissioner's motion to dismiss for lack of jurisdiction would be denied

20. Petitioner Guralnik mailed his Tax Court petition using FedEx First Overnight service:
A. Therefore, the timely mailed, timely filed rule of IRC Sec. 7502 would apply
B. At the time of filing his petition, the FedEx First Overnight service the petitioner used was a non-designated private delivery service and therefore the petitioner could not avail himself of the timely mailed, timely filed rule
C. The only way to avail oneself of the timely mailed, timely filed rule is by using the U.S. Postal Service
D. The timely mailed, timely filed rule would not apply to petitioner, but he could trudge through the snow and hand deliver the petition to the clerk of the court

GEARING UP FOR TAX SEASON

PROMOTE YOUR PRACTICE AND YOUR CREDENTIAL

BY GIGI JARVIS, CAE

AUTUMN IS THE PERFECT TIME TO BEGIN PROMOTING YOURSELF and your EA credential in preparation for the upcoming tax season. Many members already know that NAEA provides tools to help them attract new clients and raise awareness of their EA credential, but many may not know that these tools are regularly refreshed. It's time to take another look.

Last year, NAEA formed a new partnership to present the improved "Find a Tax Expert" directory. The new directory is mobile-friendly and features a variety of criteria taxpayers may choose from when selecting an enrolled agent, including location, specialty, and money-saving offers. Taxpayers may also use the directory to search for an enrolled agent who is an NTPI Fellow.® Jeff Gentner, EA, chair of the NAEA IT Task Force, spearheaded the launch of this new directory, and he has heard positive feedback from new clients he has gained through the directory.

CLIENT NEWSLETTERS ARE AN EXCELLENT MEANS FOR YOU TO REACH OUT TO CLIENTS AND POTENTIAL CLIENTS AND EDUCATE THEM ABOUT EAS.

"I was happy with the responses I had from the directory," said Kathie A. Muhler, EA. "I got three client engagements as a result of my listing and immediate responses to the requests submitted."

All NAEA directory listings are optimized for major search engines such as Google, Yahoo, and Bing. The directory provides detailed traffic stats to show you how many taxpayers saw your listing, clicked on your listing, viewed your website, and more. You also have the option to have this report e-mailed to you automatically each month. The new directory factors in the power of social media, allowing you to share your individual listing on your social media channels, as well as giving clients and prospective clients the ability to share your listing on their networks. To see all the benefits of the new directory, go to http://taxexperts.naea.org/member-benefit. Contact directory@naea.org with questions or to sign up.

A wealth of promotional resources can be found in the "Marketing Tools for Members" section of the NAEA website. This frequently updated section is where you'll find resources to help you promote your credential and your practice. It's located under the "Membership" tab. Just click on "Member Resources" in the drop-down box. You'll see "Marketing Tools for Members" listed among the bulleted items.

Here is a quick rundown of some things you'll find there, but please take a few minutes to check out the page yourself.

Brochures

NAEA creates and prints brochures that explain the qualifications enrolled agents bring to tax preparation and representation and why they are America's tax experts. We update and replenish our stock before tax season, and many members order them annually. Members keep the brochures in their waiting rooms, send them out to existing and prospective clients, or take them to job fairs or other exhibiting opportunities. There is also a printable "Record Retention Requirements" brochure. Getting these documents into the hands of your clients and prospective clients can help educate them about the advantages of hiring an EA!

NAEA Store

You can find the brochures and much more at the NAEA Store, powered by Lands' End. The store carries a wide variety of clothing for both women and men: outerwear, polos, sweaters, tops, blazers—you name it. And you can choose between the NAEA and the Enrolled Agent logos, both of which attest to your professionalism. There's also an assortment of items, such as drinkware and desk items, that can be ordered with either of the logos.

EA Ads

NAEA has produced print, broadcast, and radio ads for its members to save them the cost of production, making it less expensive to promote their credential and themselves. The print ad is available online in color and black and white in three sizes: full page, half page, and quarter page, in order to serve larger and smaller advertising budgets. There are high-resolution versions available for print publications and low-resolution versions good for websites and other digital uses.

There is also a thirty-second commercial spot that promotes enrolled agents that can be customized for your practice. You can see an example of the spot on the "Marketing Tools for Members" page, along with instructions for use. The commercial is appropriate to promote both affiliates and individual businesses. While the example shows contact information for a fictional EA at the end, the actual commercial allows space at the end to insert your affiliate information and logo or business name and contact information over the final images. Many EAs have posted this video to their websites for a quick and easy explanation of the advantages of hiring an EA. This year, we added a radio ad for member use titled "Choosing a Tax Professional."

Another item you may not know is available is the EA public service announcement (PSA) that NAEA created. PSAs can be tricky because they can't appear to be "selling," but we couched this one in terms of "Don't trust your financial information to just anyone," and members have successfully pitched it to their local TV stations.

Sample Letters

Under "Sample Letters," which includes a sample fee agreement letter, an audit engagement letter, a collections engagement letter, disclosure and waiver of potential related-party conflict of interest, and a privacy policy letter, you can find one of my favorite items: "Hey, Buddy, EAs are America's Tax Experts!" So many of us have been disgruntled (to say the least) when the media refer to CPAs, and only CPAs, as the go-to for tax issues. In truth, many CPAs aren't even required to complete continuing education in tax; their CE requirements vary from state to state. NAEA has posted sample letters that you can use to help correct this scourge.

Client Newsletters

Client newsletters are an excellent means for you to reach out to clients and potential clients and educate them about EAs. We have been told that the client newsletters alone are worth the price of membership in NAEA. The PR Committee updates the client newsletters annually, so you don't have to struggle to create content when e-mailing or mailing a newsletter to your clients. We make sure there's an updated client organizer every year.

Customizable News Releases

Members without their own PR departments—and I think that's most—can take advantage of NAEA's fill-in-the-blanks press releases to announce noteworthy events to their communities. These are accompanied by easy-to-follow instructions on distribution. Press releases can be found to announce:

- Membership in NAEA
- CE completion
- Passing the SEE
- IRS Tax Forum participation
- Achieving Fellow status
- Attending NTPI
- Attending NTPI graduate level
- Associate membership

SOCIAL MEDIA NEEDS TO BE PART OF YOUR MARKETING MIX, AND NAEA HAS YOU COVERED.

Plugging into the Speakers Circuit

In an effort to get members out in the public helping to raise awareness of EAs, NAEA has posted helpful tips for getting onto the speakers circuit. Last year, we posted two new presentations, thanks to PR Committee Chair Kerry Freeman, EA. Now, in addition to "Five Tips to Avoid an Audit," we have the presentations "Identity Theft" and "There's an App for That." Chambers of commerce, churches and temples, and local clubs, such as the Kiwanis, are often in search of meeting content—this kind of presentation is a perfect opportunity to educate groups on your practice and the EA credential.

NAEA Logo and Enrolled Agent Logo

NAEA continues to encourage members to use the NAEA logo and the EA logo. Many members are raising awareness that EAs are America's tax experts by adding one or both of these logos to their e-mail signatures and other marketing materials.

Postage Stamp

There are two professionally designed stamps in the "Marketing Tools for Members" section: an NAEA stamp and an EA stamp. NAEA had the stamps professionally designed to promote the profession and the Association. By following the instructions, you can download the artwork and create your own stamps—and promote EAs on every letter or package you send!

Social Media

Social media needs to be part of your marketing mix, and NAEA has you covered. In addition to the guidebook *Social Media 101: An Introduction to Social Media for NAEA Members*, NAEA has posted infographics for the #WhatIsanEA social

media campaign, and "I am an EA" cover images for Facebook and Twitter. If you aren't connected with NAEA on social media, please think about doing so before tax season. Our members-only Facebook and LinkedIn pages, as well as the NAEA forums, are all venues where members post tax questions that are answered immediately by generous and helpful members. Those of you on Twitter can keep track of tax and Association news by following NAEA: @tax_experts.

You've earned the enrolled agent credential, which is a lot to be proud of. This tax season, do what you can to make sure everyone knows that you're an enrolled agent—one of America's tax experts. **EA**

About the Author

Gigi Jarvis, CAE, *is the NAEA Sr. Director, Communications and Marketing. Contact her at gjarvis@naea.org with your PR questions.*

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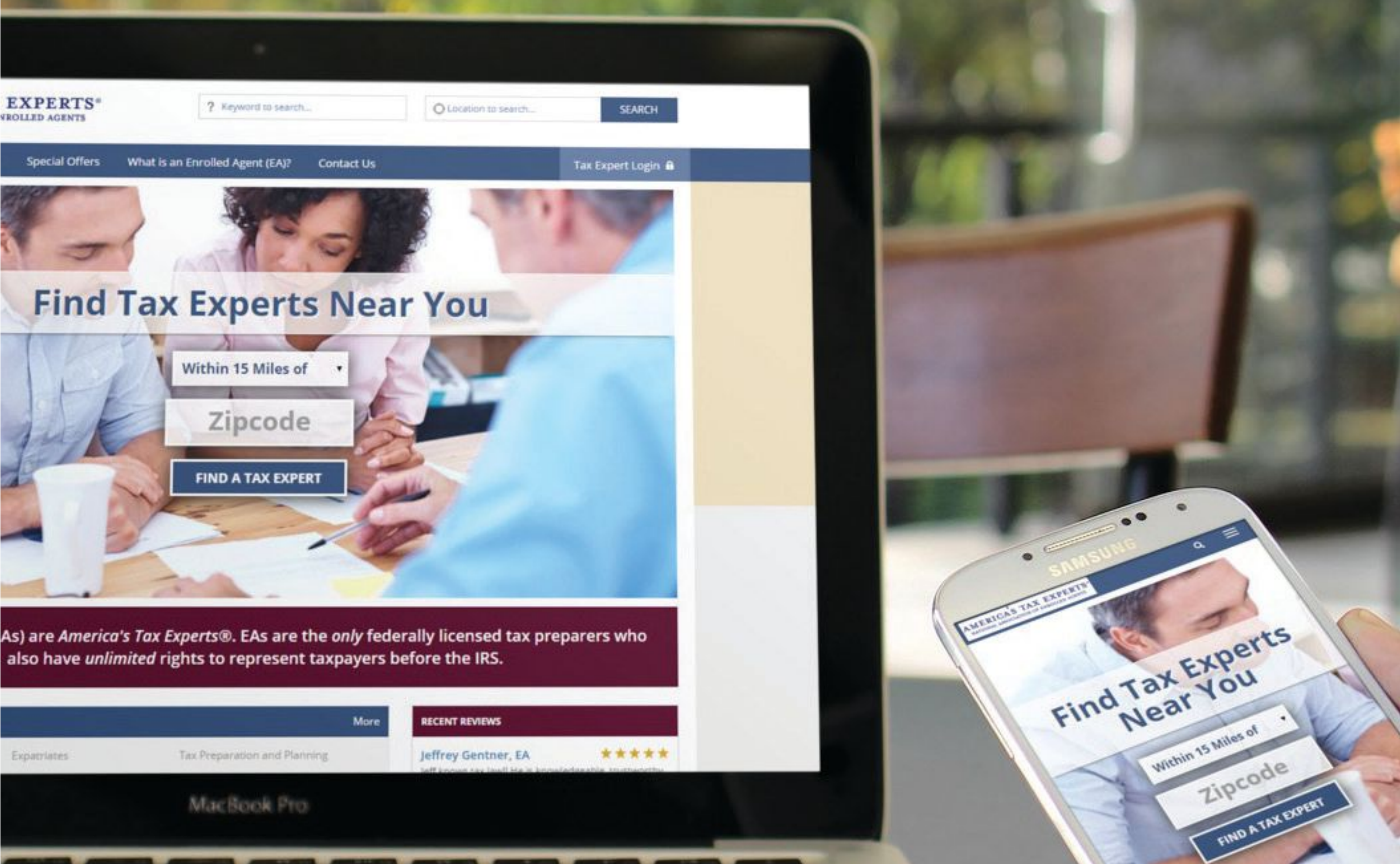

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