SEPT
OCT
2019

TODAY'S CPA

Texas Society of Certified Public Accountants

HOW TO VALUE PRIVATELY HELD PROMISSORY NOTES

PLANNING FOR PRIVACY IN A PUBLIC WORLD

TAX TREATMENT OF A FOREIGN PARTNER'S SALE AND RELATED WITHHOLDING

CRITICAL THINKING

BEFORE & AFTER PASS RATES AND THE NEW CPA EXAM

TXCPA
Texas Society of Certified Public Accountants

CHAIRMAN
Lei Testa, CPA

PRESIDENT/CEO
Jodi Ann Ray, CAE, CCE, IOM

EDITORIAL BOARD CHAIRMAN
Aaron Borden, CPA

Staff
MANAGING EDITOR
DeLynn Deakins
ddeakins@tscpa.net
972-687-8550
800-428-0272, ext. 250

TECHNICAL EDITOR
Brinn Serbanic, CPA, CFP®
technicaleditor@tscpa.net

COLUMN EDITOR
Don Carpenter, MSAcc/CPA

WEB EDITOR
Wayne Hardin
whardin@tscpa.net

CONTRIBUTORS
Anice Asberry; Melinda Bentley; Sarah Brown; Bryan Garza; Roxanne LaDu; Rhonda Ledbetter; Craig Nauta; Kari Owen

DIRECTOR, MARKETING AND COMMUNICATIONS
Melinda Bentley, CAE

CLASSIFIED
DeLynn Deakins
Texas Society of CPAs
14651 Dallas Parkway, Suite 700
Dallas, Texas 75254-7408
972-687-8550
ddeakins@tscpa.net.

Design/Production/Advertising
American Business Media
www.ambizmedia.com

SEPT OCT 2019

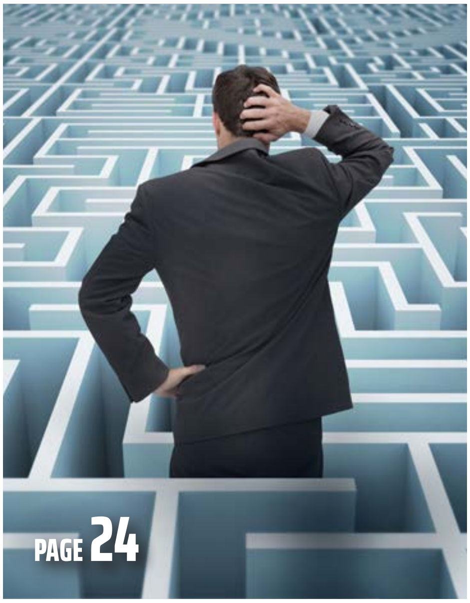
CONTENTS

VOLUME 47, NUMBER 2 **SEPTEMBER / OCTOBER 2019**

COVER STORY

FEATURES

COLUMNS


PAGE 24


PAGE 16

DEPARTMENTS

Today's CPA (ISSN 00889-4337) is published bimonthly by the Texas Society of Certified Public Accountants; 14651 Dallas Parkway, Suite 700; Dallas, TX 75254-7408. Member subscription rate is $3 per year (included in membership dues); nonmember subscription rate is $28 per year. Single issue rate is $5. Periodical postage paid at Dallas, TX and additional mailing offices. POSTMASTER: Send address changes to: Today's CPA; 14651 Dallas Parkway, Suite 700; Dallas, TX 75254-7408.

ENGAGING THE NEXT GENERATION OF CPAS

By TXCPA Chairman Lei D. Testa, CPA-Fort Worth, CGMA

Share Your Thoughts
I'd love to hear your feedback and answer your questions. Drop me a note at chairman@tscpa.net.

Welcome to your digital issue of *Today's CPA*. This format makes it easy for you to find more details related to our articles with the addition of hyperlinks in the text. Be on the lookout for links and click away for more!

I mentioned in our last issue, and in recent visits with members and chapters, that we are focused on five priorities this year. We touch on one of those priorities – Engaging the Next Generation of CPAs – in the following digital pages. This issue's cover story talks about pass rates since important changes were implemented to the Uniform CPA Exam, a critical step for bringing in new talent that has the skillset needed for the continuing evolution of the accounting profession.

At TXCPA, we're committed to helping future CPAs find their professional home in our organization. From student membership to candidate membership to special outreach focused on young and emerging professionals, TXCPA rolls out the welcome mat to engage with new and future CPAs and help them see the value of our network that's more than 28,000 strong.

The Chapters column in this *Today's CPA* issue highlights two outstanding chapters that have focused efforts on reaching students and young professionals. Volunteers in our local chapters have been hard at work recruiting the next generation by visiting schools in their communities and hosting events for students and young CPAs. There are fun and rewarding opportunities for anyone to get involved in this effort! I would encourage you to consider being involved and helping to shape the future of someone interested in our profession. You can raise your hand by emailing your local chapter or contacting TXCPA.

Thank you for your commitment to TXCPA and our profession!

SEC CONSIDERING ITS OPTIONS REGARDING QUARTERLY FINANCIAL REPORTING

By Don Carpenter, MSAcc/CPA

After President Donald Trump expressed interest in eliminating quarterly reporting, the SEC requested public comment regarding the proposal. The comments or any alternatives to the current reporting requirements for public companies has not been released.

The financial markets have been criticized for having a very short-term focus and overreacting to earnings that fail to meet expectations. This short-term focus can drive managers to make decisions that mortgage long-term profitability and cash flow for immediate results. It has been proposed that replacing the quarterly reporting cycle with longer reporting periods might alleviate some of the short-term focus. Moving to longer-term reporting cycles would also bring U.S. companies into line with other world markets. The U.K. has required its registrants to report on a six-month system for quite some time, although it should be noted that a majority still opt to release quarterly results.

One obvious disadvantage of a longer reporting cycle is that investors and financial analysts have less access to financial information. A possible outcome of any reporting modifications would be an increased importance for the SEC's Form 8-K, which is required to be filed by registrants to report material events that may be important to shareholders. Form 8-Ks are generally due within four business days of a material event and are often used to report such items as acquisitions, changes in key personnel or changes in capital structure.

A company's earnings release is also an event requiring a Form 8-K. Since the promulgation of Regulation Fair Disclosure in 2000, registrants have been required to release to the public any information made available to a more limited group. This has increased the need to use Form 8-K for financial information such as investor conference or trade show presentations. Extending reporting cycles will only increase the need to monitor the flow of financial information and determine if an 8-K filing is warranted.

Countering this disadvantage are several advantages of moving to a longer reporting cycle.

1. Investors look at interim financial statements for indications of future business performance. Even small changes in margins or volumes can be cause for concern. Arguably, reporting for longer periods offers the advantage of diluting the impact of one-off or unusual business transactions. A high volume, low margin transaction will not have as material an impact on gross profit margins over a six-month period as it would for a quarter. This may allow managers more flexibility in growing business and new customer development. Likewise, seasonality will have a less pronounced effect on performance over longer periods.

2. Unusual items, such as impairments, restructurings, and gains and losses, will be less material to overall results when included in longer reporting periods. This can allow for more focus on the fundamentals of the business and less incentive for organizations to "manage" the timing and amount of such adjustments.

3. With longer interim periods, financial reporting personnel can devote more resources to management reporting and performance analysis. It is not unusual under current reporting requirements for management to require monthly financial statements to assess business performance.

This process would likely remain if interim periods are extended. However, without the demands of producing quarterly 10-Ks, resources could be re-deployed to give management more detailed and

Don Carpenter is clinical professor of accounting at Baylor University. Contact him at Don_Carpenter@baylor.edu.

timely information that is relevant to operational decisions.

4. Inter-period accounting requirements for such items as period costs and income taxes can be quite complex and may yield unexpected results. Likewise, recording contingencies and revisions of accounting estimates in the proper period can be very difficult. Companies often "hold their breath" as interim reports are processed, due to the concern that such issues that did not previously meet the requirements for accrual might progress to the point that earnings should be revised, further complicating an already laborious process.

Discussions between management and the assurance team regarding what the company knew and when are very common as outside review of interim reports includes the proper timing of accruals. Eliminating quarterly reporting in favor of semiannual reports should reduce these issues.

In conjunction with the current review of interim reporting, the SEC should consider what additional disclosures investors would consider helpful. Reducing the burden of interim reporting might afford an opportunity for additional disclosures that registrants have resisted.

However, additional disclosures might also necessitate a review of the filing deadlines for annual reports. Many large filers struggle to meet the current 60-day deadline. Unless new disclosures are not sensitive to year-end financial information, eliminating interim reports may not increase the bandwidth for additional or more detailed disclosures. That may require extending the due date for Form 10-K annual reports.

Reducing the interim reporting requirements for U.S. registrants will require adjustments on the part of all parties involved in the process. Registrants would have to review and adjust workflows and staffing to effectively and efficiently utilize resources. Assurance firms would have to adjust audit programs, as interim reviews and financial information would be available less frequently. And most importantly, markets and shareholders would have to adjust their expectations for frequent financial information in a system that thrives on short-term performance.

You can read public comments on earnings releases and quarterly reports on the SEC website.

2018-2019 OUTSTANDING CHAPTER AWARDS

By Rhonda Ledbetter, TXCPA Volunteer and Governance Specialist

To inspire chapters in their continuing work to elevate member service, TXCPA bestows Outstanding Chapter Awards to the small and medium-sized chapters. Selection is made by a group of past presidents from chapters of all sizes, who understand the work involved in successfully leading volunteers. Here are a few highlights about the chapters honored for the 2018-2019 year.

Outstanding Small Chapter: Southeast Texas
President: Wendi Christian, CPA, CGMA

To compete with other exhibitors for the attention of more than 3,000 high school students at the Southeast Texas Youth Career Expo, the chapter generated awareness of the profession with a low-cost, high-impact display. A member's Corvette and a ski boat were parked near the main entrance, with signs saying "Owned By A CPA."

For the eighth year, a tailgate party before a Lamar University football game was hosted for accounting students, faculty and chapter members. The event provided an opportunity for casual interaction and networking – valuable for students hungry for a chance to learn more about the people who comprise the accounting profession and about their career paths.

A school supplies drive for grade school children was held for the 11th year. The project serves a disadvantaged elementary school in a different city in the chapter area each time. In addition to meeting the challenge of continuing the project, the volunteers inspired an increase in the volume of supplies donated.

The chapter works to encourage participation in TXCPA, especially attendance at the two TXCPA Board meetings. There were 10 members at the Annual Meeting and 10 at Advocacy Day, despite the chapter's remote location and small size. For the sixth consecutive year, their attendees included at least one member who had not been to a TXCPA Board meeting before.

Outstanding Medium-sized Chapter: Central Texas
President: Lindsey Skinner, CPA, CGMA

Assisting Mission Waco with their annual drive, the Young CPA Committee collected almost $3,000 and bought 232 backpacks, 1,000 bottles of hand sanitizer and 1,400 pairs of socks. The increase in donations was almost 200% over the previous year. Especially noteworthy, the chapter had 15 new volunteers among the 38 who stuffed backpacks with supplies and distributed them to appreciative parents.

The chapter added a charitable project: testing donated appliances and restocking a nonprofit resale store. There were four new volunteers among the six working on a Saturday afternoon. This was in addition to recruiting 11 new volunteers for the chapter's participation in the annual HEB Feast of Sharing, a community-wide free meal. Volunteers seated people, worked in the serving line and brought plates to the tables. More than 6,500 individuals enjoyed a warm holiday dinner and entertainment by various community groups.

To help the CPA-PAC contribute much-needed funds to political candidates and incumbents who understand the importance of the critical role of the CPA in preserving the state's business climate, an event was held where almost 30 CPAs met with Texas State Representative Kyle Kacal and Senator Brian Birdwell. This was the first PAC gathering in years and the first time for chapter members to meet the two key legislators. Another new project was personal thank you letters to all area CPA-PAC donors from the chapter chair.

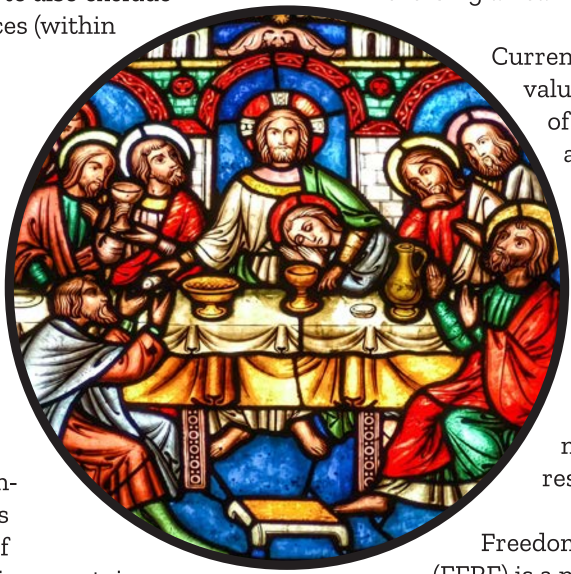
Help Make Your Chapter Award-Winning

Members are the key to – and the reason for – chapter success. Contact your local president or executive director and find out how you can get involved in making yours an award-winning chapter! You can get contact information through the TXCPA website.

CLERGY HOUSING EXCLUSION RULED CONSTITUTIONAL IN CIRCUIT COURT CHALLENGE

By R. Dan Fesler, DBA, CPA, CMA, CIA, and Richard Rand Ph.D., CPA

As of the most recent U.S. Religious Census, there were more than 27,000 churches, synagogues, temples, mosques and other religious congregations in Texas. Since the 1920s, Code Section 107[1] has allowed ministers and other similarly situated religious officials in these congregations to exclude from income the value of in-kind housing provided by the religious organization. In the 1950s, Section 107[2] was added to also exclude ministerial cash housing allowances (within limits) from income.



In 2013, the exclusion for clergy cash housing allowances was ruled unconstitutional by a federal court in Wisconsin,[3] possibly setting the stage for eventual elimination of clergy housing exclusions nationally. On appeal in 2019, however, the 7th Circuit Court of Appeals ruled such exclusions are constitutional.[4] Going forward, further legal challenges to religion-friendly Section 107 are likely. This article provides a brief overview of Section 107 clergy housing exclusions, certain background information and discussion of the 7th Circuit Court's 2019 decision.

Background Information

Prior to the 1913 passage of the 16th Amendment, the government allowed tax exemptions for church property. After the passage of the 16th Amendment and the establishment of a federal income tax, the IRS established a rule that exempts employer-provided housing from being taxable, referred to as the "convenience-of-the-employer" doctrine. This would include housing provided to sailors aboard navy ships, on-base housing for other members of the military, work camp housing, etc. However, the doctrine was not made available for housing provided to ministers.

In 1921, Congress created an exemption for church-provided in-kind housing for ministers via what is now Section 107(1) of the tax code. Until the passage of Section 107(2) in 1954, however, there was no exemption for cash housing allowances paid to ministers. In a 1955 8th Circuit Court of Appeals decision, *Williamson v. Commissioner of the IRS,*[5] Section 107(2) was upheld, reversing an earlier Tax Court decision.

Currently, ministers may exclude the value of in-kind housing or the lower of (1) the amount of any cash housing allowance designated in advance by their employing organization, (2) the amount of the designated allowance actually used for housing, including utilities, furnishings and maintenance, or (3) the fair rental value of the housing (including utilities, furnishing and maintenance) the minister uses as his/her personal residence.

Freedom From Religion Foundation (FFRF) is a national nonprofit organization[6] opposing the exclusion of Section 107 ministerial housing allowances. FFRF has continuously and regularly engaged in legal actions challenging entanglement of religion and government, as well as government endorsement or promotion of religion. Per the FFRF website:

with more than 30,000 members … (FFRF) works as an effective state/church watchdog and voice for free thought (atheism, agnosticism, skepticism).

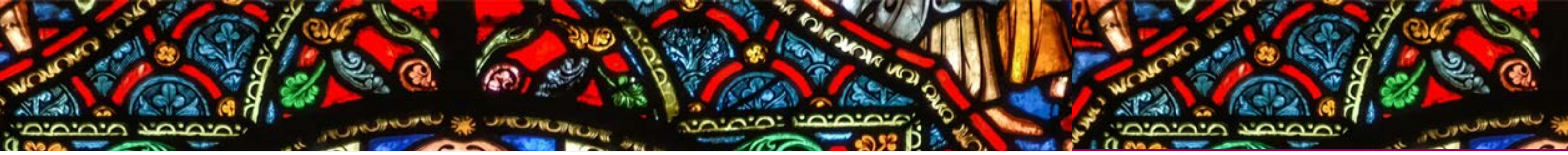
The FFRF website also provides a listing of its active lawsuits and recently won lawsuits.[7] FFRF lawsuits have challenged things like prayers at City Council meetings and in government-owned facilities, Ten Commandments monuments, Bible classes in public schools and distribution of New Testaments in public schools by the

Gideons International[8] organization. Annie Gaylor and Dan Barker (co-presidents of FFRF) were plaintiffs in the ministerial housing litigation reported on in this article.

As previously mentioned, a 2013 decision for the plaintiffs in the Federal Court for the Western District of Wisconsin ruled that Section 107(2) was a violation of the Establishment clause of the U.S. Constitution.[9] In 2011, to gain standing in the courts to challenge 107(2), Co-Presidents Gaylor and Barker had started receiving cash housing allowances from FFRF. They filed suit against the government (IRS) arguing that leadership of groups similarly situated to ministers (including FFRF leadership) should be entitled to housing allowance exclusions.

Upon commencement of the 2011 case, Gaylor and Barker had never actually claimed housing exclusions on their returns, arguing vigorously that they were NOT ordained, commissioned or licensed as ministers. Absence of the exclusion being formally denied caused significant delay of the issue being reheard at the appeals court level until 2018-2019.

In the 2013 case, the government indicated that Gaylor and Barker could have possibly successfully claimed the



exclusion given the broad interpretation and application of the statute's "ministers of the gospel" terminology. In support of this position, the government suggested that atheistic beliefs can sometimes play a role similar to traditional religious beliefs. The government also contended that the de-baptism certificates issued by FFRF (signed by Barker) were somewhat akin to a sacerdotal function in some organized religions.

Continuing with this line of reasoning, the government cited the fact that Gaylor had earlier been named by Wisconsin's *Madison Magazine* as Madison's favorite religious leader. To advance the case to the appeals level, it was necessary for Gaylor and Barker to file amended returns claiming exclusion of their housing allowances, which the IRS then denied. Denial of the exclusion, and the resultant injury, gave the plaintiffs legal standing for the circuit court to reconsider the lower court decision.

Currently, ministers may exclude the value of in-kind housing or the lower of the amount of any cash housing allowance designated in advance by their employing organization ...

Circuit Court's 2019 Decision

Court reasoning in the 2019 decision draws heavily from a three-prong test in the 1971 Lemon case.[10] There, it was ruled that to be constitutional, a statute must have a *secular purpose*, not advance nor inhibit religion, and not foster excessive government entanglement. The court also considered the *historical significance* test in making its decision.

Secular Purpose. The circuit court opined that Section 107 does have a secular purpose, in that it explicitly puts ministers on par with secular employees allowed housing exclusions under the Section 119(d) convenience-of-the-employer doctrine. The court cited several examples of other "carve-outs" for certain types of employees with special housing needs/arrangements.

Not all ministers benefitting from Section 107 housing exclusions use their homes in their ministries or as an extension of church property. The court recognized this fact and explicitly stated that Section 107, like certain other Code Sections, is therefore overinclusive. On this point, the court also indicated that Section 107, like certain other legal rules (that are also overinclusive), is imprecise and not required to be a perfect fit with all of reality.

The court further pointed out that the strict requirements of 119(d) are sometimes eased for the sake of administrative efficiency. Such easing eliminates the necessity of case-by-case analysis of relevant factors to determine the extent the minister's home is used in ministry and thus the percentage of housing allowances that are excludable. It was stated that Section 107 is not just a special tax benefit for ministers, but rather part of an overarching arrangement in the law for taxpayers (religious and secular) with employer-provided housing.

Neither Advances nor Inhibits Religion. From the 1953 record, the plaintiffs quoted the sponsor of Section 107(2), Representative Peter Mack, to make the point that the statute was meant to be a special benefit for ministers/religion from its inception:

Certainly, in these times when we are being threatened by a godless and antireligious world movement, we should correct this discrimination against certain ministers who are carrying on such a courageous fight against this foe.[12]

The "certain ministers" language in this quote refers to ministers receiving cash housing allowances as opposed to those provided in-kind church owned housing (e.g., parsonages).

The circuit court pointed out that Mack made other statements in 1953 endorsing passage of Section 107(2), due to its elimination of discrimination between ministers living in church provided housing vs. those living in housing they must pay for themselves (a valid secular purpose of legislation). Also, the court took the position that one statement by Mack did not necessarily establish his motive(s) for sponsoring Section 107(2). In addition, even if Mack's motivation was to enact a statute benefitting religion, the fact that the statute was voted on by a House of Representatives with 435 members precluded ascribing responsibility for the statute on religious motivations.

FFRF contended that a tax benefit or exemption for religious workers is identical to a government subsidy for religion and, thus, advanced religion. The circuit court dismissed this FFRF charge by quoting the Supreme Court:

The grant of a tax exemption is not sponsorship, since the government does not transfer part of its revenue to churches, but simply abstains from demanding that the church support the state.[13]

Excessive Entanglement. Per the circuit court opinion, as referred to above, the Section 107 bright-line rule allowing exclusion of ministerial housing allowances precludes any need for the government to intrude, on a case-by-case basis, on religious organizations by conducting inquiries into how, and to what extent, their facilities or resources are used for church business. The result is less government entanglement in religion than would exist absent Section 107.

Historical Significance Test. The court pointed out that the federal government has enacted federal tax exemptions for religious organizations as far back as 1802. In 2013, the district court's opinion ruling that housing exclusions were unconstitutional had distinguished 107(2) as an income tax provision, as opposed to the myriad of other state and federal religious exemptions (which number more than 2600 and relate predominantly to property taxes). The circuit court said this was "too fine a distinction." Rather, Congress, with Section 107, was simply continuing its historical practice of exempting certain church resources from taxation.

Exclusions Remain Constitutional

For now, Section 107 exclusions for ministerial housing remain constitutional. However, both the circuit court decision and the earlier federal district court decision remain instructive, as arguments on both sides of the issue will (no doubt) resurface in the courts. Will FFRF and its officials gain a rehearing of the issue with the U.S. Supreme Court?

About the Authors:
R. Dan Fesler, DBA, CPA, CMA, CIA, is a Professor of Accounting at Tennessee Technological University. Contact him at DFesler@tntech.edu.

Richard Rand Ph.D., CPA, is a Professor of Accounting at Tennessee Technological University.

[1]U.S. Religious Census (2010), TexasCounties.net/statistics/churches2010.htm.

[2]Text of the tax code refers specifically to "ministers of the gospel." However, courts have consistently held that the statute applies to religious leaders of any denomination/religion regardless of formal title; e.g., for purposes of Section 107, a Jewish cantor is a "minister of the gospel," as well as Buddhist, Taoist and Secular Humanist religious leaders. Also, in this article, the term "church" includes temples, synagogues, etc.

[3]Freedom From Religion Foundation, *Gaylor and Barker v. United States of America.* U.S. District Court for the Western District of Wisconsin, Case No. 11-cv-0626.

[4]*Gaylor, et al., v. Mnuchin, et al.,* U.S. Court of Appeals for the Seventh Circuit, Case Nos. 18-1277 and 1280, (March 15, 2019).

[5]*Gideon B. and Audrey J. Williamson v. Commissioner of Internal Revenue*, 224 F.2d 377 (8th Cir. 1955).

[6]FFRF members nationwide select state representatives to the organization's Executive Board of Directors.

[7]For more on FFRF lawsuits, see https://ffrf.org/legal/challenges/ongoing-lawsuits.

[8]Gideons International is an association of Christian businessmen organized in 1908 to provide Bibles globally. The association has placed more than two billion Scriptures worldwide in more than 95 languages and 200 countries, territories and possessions.

[9]The Establishment Clause (separation of church and state) mandates equal treatment of different religious organizations and secular groups per *United States v. Lee*, 455 U.S. 252, 263 n2, 102 S. Ct. 1051, 71 L. Ed. 2nd 127 (182).

[10]*Lemon v. Kurtzman*, 403 U.S 602 (1971).

[11]Section 911 excludes housing above a certain level provided to citizens living abroad while Section 912 excludes housing provided to government employees. Other Code Sections exclude housing provided for employees away on business for less than a year and to current or former members of the U.S. military.

[12]Hearings before the Committee on Ways and Means: Statement of Hon. Peter F. Mack, Jr., on H.R. 4275, Concerning the Taxability of a Cash Allowance Paid to Clergymen in Lieu of Furnishing Them a Dwelling, 83d. Cong. 31, at 1576 (June 1953).

[13]Walz, 397 U.S. at 675.

EXCEL TIPS & TRICKS

By Jennifer Johnson, CPA

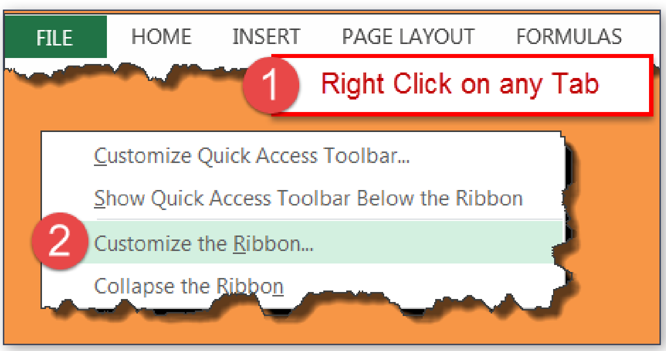
Excel is a technology tool designed to help you do more work in less time. The following tips and tricks are available to better leverage this useful tool. The instructions are based on the use of Microsoft Excel 2016.

Speak Cells

You can use the Speak commands in Excel to help verify data input. Any data entered on an Excel worksheet can be read back to you using the Speak commands. The Speak commands in Excel have to be custom added to your Ribbon.

To customize the Ribbon, start by first **right-clicking** on any one of the Ribbon tabs and then select **Customize the Ribbon.** See Figure 1.

Figure 1.



You can then add the new commands to the Ribbon by creating a new tab and group.

1. From the **Choose Command From** dropdown, select **Commands Not in the Ribbon.**

2. Select **New Tab** and this will automatically give you a new tab and a new group. Note that commands can only be added into groups.

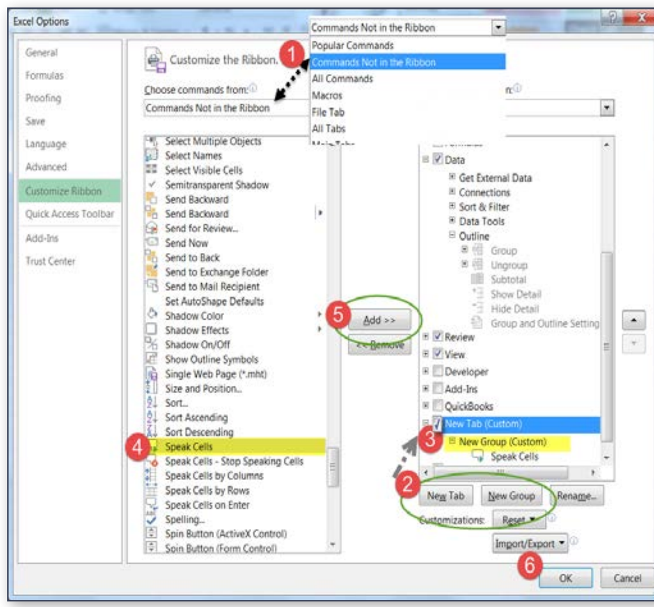
3. Select the **New Group (Custom)** that you just created.

4. From the command list on the left, select the **command(s) (i.e., the Speak Command)** you want to add to your new tab/group. See Figure 2 for a list of Speak commands.

5. Select **Add.**

6. Select **OK.**

Figure 2.

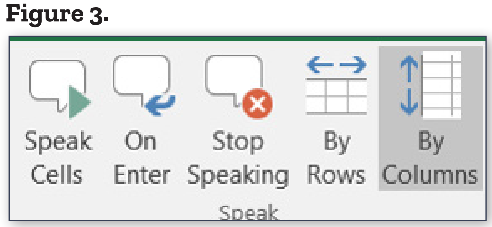


Your options for the Speak commands are:

- Speak Cells: Reads a selected range of cells
- Speak Cells – Stop Speaking Cells: Stops the reading of cells
- Speak Cells by Columns: Reads cells by columns
- Speak Cells by Rows: Reads cells by rows
- Speak Cells on Enter: Reads the cells on enter (click to turn off)

The new commands will appear in your new tab/group as shown in Figure 3.

Figure 3.



Creating "Tooltips" Using Data Validation

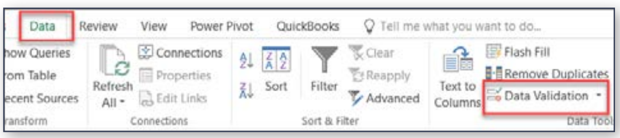
A **tooltip** is a message that appears when a cursor is positioned over an icon, image, hyperlink or other element in a graphical user interface. You can use the **Data Validation** function in Excel to display an input message that functions as a tooltip. Every time that cell is selected, the tooltip (a.k.a., Input Message) will appear. These can be used in place of comments in a cell.

To create the tooltip:

1. Select the field where the data is entered.

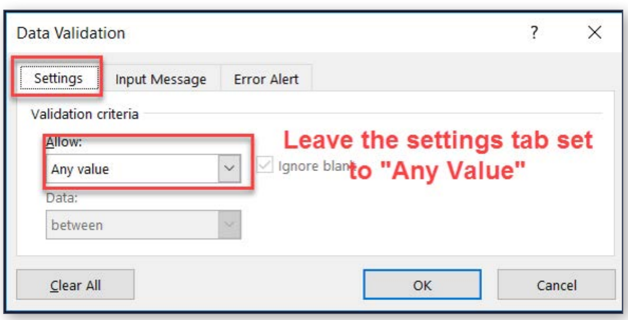
2. Select **Data Validation** from the **Data Tab** on the Ribbon. See Figure 4.

Figure 4.



3. No changes are necessary on the Setting tab. See Figure 5.

Figure 5.

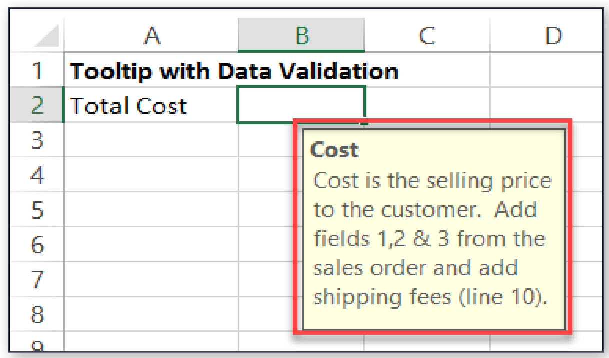


4. On the Input Message Tab, select **Show the message when the cell is selected** and enter your input message. See Figure 6.

Figure 6.

5. Every time that cell is selected, the tooltip will appear, providing insight into what is required for entry into that field. See Figure 7.

Figure 7.



Input messages cannot be printed and only appear when the cell is selected. Unlike comments, there are no indicators showing a tooltip is available.

About the Author:
Jennifer Johnson, CPA, is a Sr. Lecturer in Accounting at The University of Texas at Dallas. She may be contacted at jennifer.johnson@utdallas.edu.

TAKE NOTE

Transforming Your CPA Firm: Learn How You Can Leverage Advisory Services to Drive Service and Revenue

As client needs and expectations continue to evolve, the environment in which you serve your clients is evolving too. To stay relevant and profitable, firms need to look beyond traditional compliance-only models and shift to advisory services.

Join TXCPA and Thomson Reuters for an intensive half-day seminar – in Dallas on October 23, Austin on October 24, and Houston on October 25 – to learn how you can position and monetize advisory services at your firm. You'll earn six CPE hours and leave the seminar with the basic tools you need to begin selling your advisory services as part of the business relationship you have with new and prospective clients.

TXCPA members register for $499 and non-members pay $599. Click here to view the agenda, meet the speakers and register today for this informative seminar offered in three different cities this fall.

Exclusively for Members: Don't Miss TXCPA's Next FREE CPE Webcast on September 25

Thank you for your membership! Among the many valuable benefits you receive every year as part of your membership are TXCPA's FREE Professional Issues Update webcasts. The next webcast, sponsored by Goodman Financial, is scheduled for Wednesday, September 25 from 10 a.m. – noon.

Don't miss this opportunity to earn two CPE hours while learning more about current issues and developments in the accounting profession. Register now on our website.

TXCPA PEER ASSISTANCE

Peer Assistance Foundation's 25th Anniversary

Established in 1994, the foundation is the entity that accepts grants and donations to fund peer assistance work for Texas CPAs, candidates and accounting students. Through the Accountants Confidential Assistance Network (ACAN), tools are available to help them deal with alcohol, substance abuse, depression, stress or other mental health issues.

The Texas Legislature passed the Peer Assistance Programs statute (Chapter 467) in 1989 to promote the creation of approved projects designed to help impaired professionals. TXCPA has worked in coordination with the Texas State Board of Public Accountancy (TSBPA) to develop its program centered around ACAN, a statewide network of recovering CPAs. The statute allows a licensing board to contract with, provide grants to, or make other arrangements with a professional association or other institution to implement a peer assistance program.

TSBPA Rule 502.1 – Peer Assistance to Licensees provides underpinning for ACAN. If the State Board receives information that a licensee might have a possible substance abuse or mental health issue, an option is to refer that person to an approved peer assistance program.

Grants from TSBPA have enabled improvement of TXCPA's Peer Assistance Program, such as:

- staffing for the program,
- recruitment efforts to secure other CPAs for the network,
- expanding the confidential hotline,
- increasing outreach to schools and universities,
- helping TSBPA assess exam candidates, and
- continuing to assist and evaluate licensees referred by TSBPA.

In return, the Peer Assistance Foundation reports to TSBPA on a quarterly basis with information, such as the number of individuals receiving services and the number of volunteers.

ACAN complies with Chapter 467 of the Texas Health and Safety Code and with related regulations issued by the Texas Commission on Alcohol and Drug Abuse. By meeting these requirements, the program allows individuals involved in administering and operating the program to be protected from civil liability. Another key provision is that Chapter 467 requires confidentiality, giving a safe haven for those in need to discuss their problem.

The network offers support and makes referrals to appropriate treatment programs. CPAs come forward to share their experiences with other CPAs, candidates and accounting students. Volunteers in the network receive valuable training on chemical dependency and mental illness, as well as intervention skills.

The Texas model is a good example of how the CPA profession and state regulators can partner to help address these problems that could challenge any individual at some point in his/her life. Grants and contributions to the foundation enable its good work to continue. Learn more about ACAN and the work that they do and consider donating an anniversary gift!

Take Advantage of TXCPA's Career Center to Find or Post a Job

Are you looking for an outstanding go-to resource to find or post an employment position? Our online Career Center is for you! This resource can assist you in searching for a new job or hiring just the right candidate.

TXCPA members receive exclusive savings on postings and can select options that provide enhanced visibility of their openings. Check out the Career Center for job opportunities aimed specifically at accounting and finance professionals.

Annual Meeting

JUNE 2019

TXCPA ANNUAL MEETING OF MEMBERS AND BOARD OF DIRECTORS MEETING

Harnessing the Power of Community and Connection

By Rhonda Ledbetter, TXCPA Volunteer and Governance Specialist

CPAs know the power of community and connection to lift their career. At the Annual Meeting in June, TXCPA members came together to receive the knowledge and inspiration they need to be a driving force. They left with the motivation to be the vanguard helping propel CPAs toward a more prominent advisory partnership role.

Reimagine: The Changing Landscape of the Profession

Thought leader Barry Melancon, CPA, CGMA, AICPA president & CEO, challenged the group to rethink the profession amid a world moving at turbo speed. Technology is changing in the blink of an eye and disruption is the new normal in every aspect of life. The opportunities for CPAs are immense.

He discussed once-solid businesses that have crumbled recently and drew parallels to what could happen to the CPA brand. He pointed out that those companies had a significant role in improving the well-being of society and were on the leading edge … but paused and lost so much momentum they couldn't continue. They underestimated the rate of change, which is a risk that CPAs can't afford. He pointed out that the profession as it's known today isn't what it has always been and was shaped by visionaries who could see beyond the horizon.

After discussing the present day, he moved on to thoughts about creating the future. A large number of the nation's biggest accounting firms have come together with AICPA to look at ways to redesign and constantly reinvent the audit model. Tens of millions of dollars have been invested in the Dynamic Audit Solution initiative, which will leverage big data and robotics to transform auditing. Key elements will include methodology, technology, competency and standards, with tech exploding as the greatest element of change.

Melancon then turned his attention to the most important asset: people. According to the recently released *2019 Trends in the Supply of Accounting Graduates and the Demand for Public Accounting Recruits* report, there is a trend toward firms hiring fewer accounting graduates and more staff with advanced tech skills – increasingly hiring from industry to provide intensified client service.

Evolving Roles

CPAs must constantly think about ways that technology can replace their output. For instance, accountants doing tax work should have the expectation that the next generation will think of tax as a byproduct, not as an issue that drives their thinking. The CPA must be a trusted advisor, not stay in a compliance role, and have the ability to counsel employers and clients about dealing with uncertainty.

Attest is currently the core service the profession offers. That will face a challenge as business changes. Will the CPA brand be redefined to include more technical expertise and less detailed accounting/audit knowledge? He provoked thought by posing the question of what type of professional would be best equipped to lead a future audit of a company such as Apple.

When it comes to winning with innovation, it's about thinking small and consistently making decisions that have a strategic impact.

Leading with Innovation

Scott Steinberg, president & CEO of BIZDEV, spoke about how to future-proof yourself, fearlessly innovate and succeed in the new normal. These are demanding and unpredictable times. You must be ready to adapt, juggle and understand the process of managing change. The key is to stay relevant and resilient.

Steinberg said that evolutionary changes are more effective than revolutionary ones. For sustainable innovation, it's important to understand how to create a framework for success.

Think big – start small – learn fast. Maybe just a slight shift in strategy is what will catapult you to the next level. This is the best time to put systems and solutions in place to listen to the marketplace from the bottom up. He closed with a quote from Jack Welch, "An organization's ability to learn, and translate that learning into action rapidly, is the ultimate competitive advantage."

Positioning the Profession

An educator's perspective on positioning the profession was given by Anu Varadharajan, a former lecturer at Tulane University. In an interactive session, she involved participants in sharing ideas about external factors that have changed: technology, globalization, more standards and increased scrutiny of work product.

The group looked at how the accounting career landscape has been altered by a dramatic increase in the frequency of job changes among young workers. In addition, corporate culture has shifted, because those individuals are very comfortable interacting with supervisors and management and stating what they want as employees.

The conversation moved to where the profession is going and what its future looks like. A constant is that CPAs continue to be competent and ethical, but new career paths have opened up, with options such as data analytics, mergers and acquisitions, and treasury.

In addition to students and candidates, other stakeholders playing an important role in the future include employers, professional associations, educators and businesses:

- Employers – especially CPA firms – have an impact on the profession's future by the work culture they promote.
- Professional associations can be the driving force for changing perceptions, with members visiting classrooms in a fun and creative way to share their experiences.
- Educators can show students how the information they're learning will translate into real-world applications; they should bring into the classroom CPAs who are doing innovative work.
- Businesses have a role by viewing accounting professionals as collaborative advisors who should be at the table before decisions are made – not just the finance watchdogs.

A challenge was issued for each CPA to go back to his/her community and personally tell at least three young people how they can have any career they want with a CPA certificate. The sky's the limit!

CPA Evolution

A joint project between the National Association of State Boards of Accountancy (NASBA) and AICPA is focused on evolving CPA licensure to reflect the skills and knowledge increasingly needed in a technology-driven marketplace.

According to the World Economic Forum, job roles in traditional accounting, bookkeeping and auditing are expected to decline. However, roles involving technology and business intelligence are expected to become more prominent. The job of CPA leaders is to embrace these changes and include the skills and competencies that ensure a vibrant and relevant profession.

Clients are demanding services that require knowledge in technical areas, such as information technology, cybersecurity, IT governance and data analytics. In response, the profession is evolving its core services to better meet the public's, clients' and employers' needs.

NASBA and AICPA asked how we can make sure the CPA profession is relevant years from now. The answer is the CPA Evolution initiative.

How do we get there? NASBA and AICPA developed five principles to guide the development of any new licensure model, which were reviewed at the Annual Meeting.

Participants met in groups and feedback about the principles was collected. (TXCPA provided feedback to NASBA and AICPA in August). Sample licensure models will be developed for consideration at AICPA's Fall Council meeting. These sample models will also be distributed to profession stakeholders for further discussion.

TXCPA Priorities for 2019-20

Please see the Chairman's Message in the July/August 2019 issue of *Today's CPA* to learn more about TXCPA's five priorities for 2019-20, which were unveiled at the meeting:

- Engaging the next generation of CPAs,
- Enhancing state and chapter collaboration,
- Extending our brand to promote the profession,
- Expanding digital learning opportunities,
- Educating stakeholders on the importance of professional licensing.

CPE Foundation – What's New for Members

During the annual meeting of the TXCPA CPE Foundation, Chair of the CPE Advisory Board Edie Cogdell, CPA-San Antonio, CGMA, shared an update on the dynamic Learning Management System (LMS). CPE offerings can be grouped into two categories: live events and online, with three delivery methods.

Within live events, CPE content is available through attending in-person or via webcast. The LMS platform is used to broadcast a live event that provides learners with the ability to interact with the instructor via chat or email. On-demand courses can be taken at any time and do not depend on instructor availability. These are also delivered through the same LMS platform.

As of publication time, there are already almost 100 titles that are either TXCPA-produced courses or are in the production pipeline, providing a strong, competitive range of quality content from local experts in the current market.

Two new delivery options are the TXCPA Passport and Webcast Pass, allowing unlimited access to a specially selected group of courses. While the base continues to be live events, the courses available through the LMS platform comprise approximately one-third of total course delivery.

TXCPA is committed to developing a well-balanced curriculum, with accounting and auditing, tax, business and industry, and nonprofit organization topics among those under development. Using member feedback, TXCPA is continuing to provide Texas-focused, state-specific CPE offerings.

Peer Assistance Foundation Early TXCPA Champions

Mason Backus, CPA
John Beall, CPA
Rex Cruse, JD, CPA
Morris Johnson, CPA
Tim LaFrey, JD, CPA

Peer Assistance Foundation

Steve Mize, CPA-Fort Worth, CGMA, conducted the annual meeting of the Peer Assistance Foundation. The organization's mission is to inform Texas CPAs and accounting students about chemical dependency and mental health issues and assist in their recovery.

TXCPA's 2019-2020 Chairman Lei Testa, CPA-Fort Worth, CGMA

This year is the 25th anniversary of the foundation's formation. The efforts of its early champions to help establish the entity ensures that TXCPA can offer programs such as the Accountants Confidential Assistance Network (ACAN) – a statutory peer assistance program specifically dedicated to helping Texas CPAs, CPA candidates and accounting students. Please see the Take Note section in this *Today's CPA* issue for more information on the foundation's 25th anniversary.

Accounting Education Foundation

The President of the Accounting Education Foundation Board of Trustees, Art Agulnek, CPA-Dallas, provided an update on the work of the foundation. Some of the projects include:

- Underwriting the Accounting Education Conference, an event where educators network and obtain relevant continuing professional education;
- Making a contribution to the AICPA Minority Scholarships, with $30,000 given to students in Texas; and
- Awarding $2,500 scholarships to 50 qualified accounting students at Texas universities.

To help the foundation continue to thrive, the trustees sold dream vacation raffle tickets during the Annual Meeting. The net raised was more than $26,000. Tax-deductible donations can be made throughout the year (login required).

2019-2020 Executive Board
Go to TXCPA's website

TXCPA Award Recipients and Criteria
Go to TXCPA's website

Also, please see the Chapters column in this *Today's CPA* issue for highlights from the Outstanding Chapter Awards.

CPA-PAC

CPA-PAC Chair Jesse Dominguez, CPA-Austin, CGMA, stated that part of TXCPA's legislative success can be attributed to the many members who contribute to the PAC. Thanks to their participation, the TXCPA CPA-PAC can financially support business-friendly legislative candidates across the state.

The 2020 election season has begun. The PAC must be able to continue to support legislators and candidates who understand the importance of a sound Texas economy and the crucial role of CPAs in preserving the state's business climate.

Dominguez highlighted the 2019 calendar-year fundraising goal, and he encouraged members to mobilize in their chapters and use the rest of the year to exceed their target amounts.

Business Matters

The 2018-2019 financial report was given. 2019-2020 Treasurer Billy Kelley, CPA-Permian Basin, CGMA, presented budgets for the new fiscal year, which were approved.

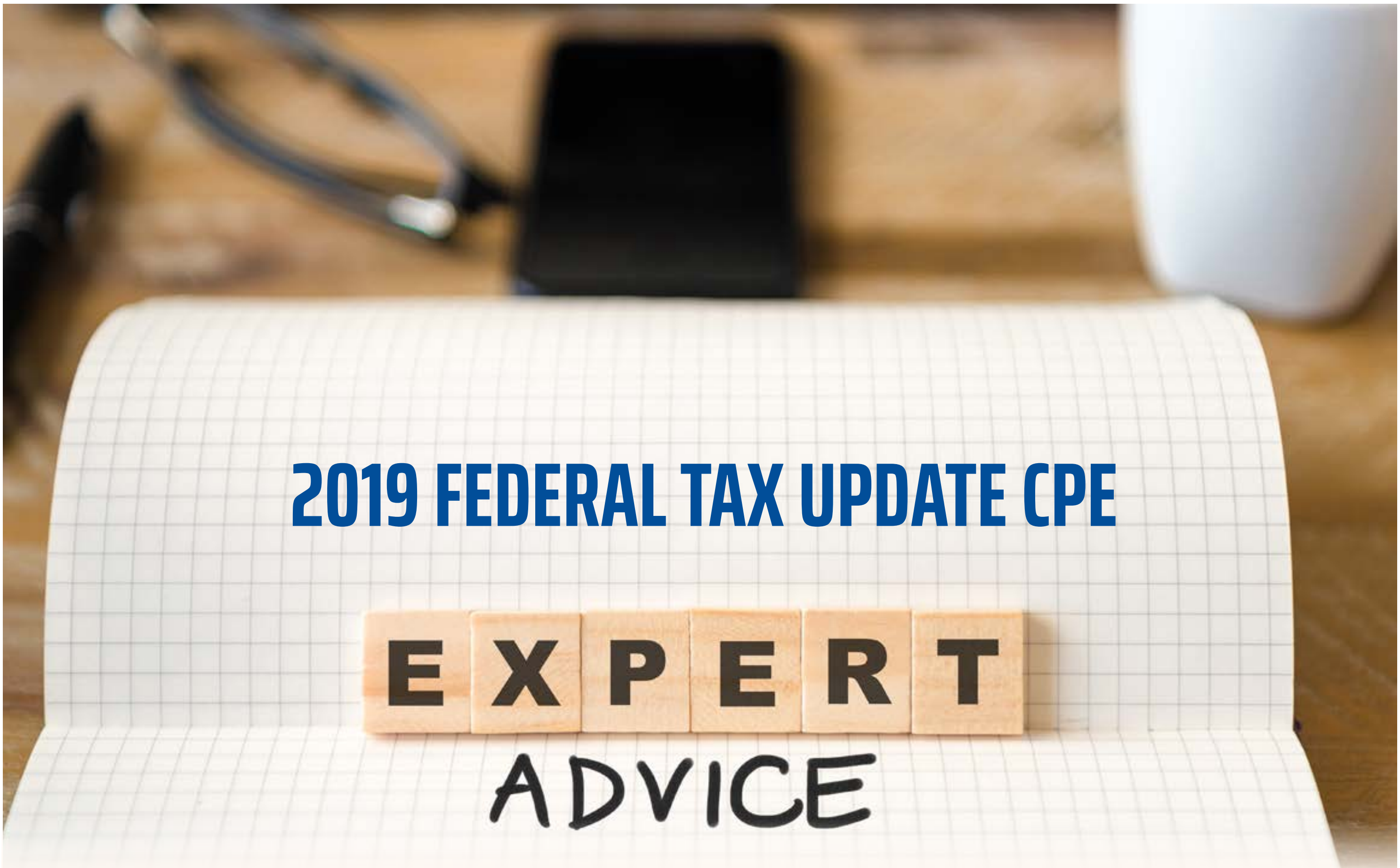
During the annual meeting of the Accountancy Museum of the Texas Society of CPAs, Inc., 2019-2020 directors were elected.

Plan Now for Future Gatherings

Deepen your TXCPA engagement at the Midyear Board of Directors and Members Meeting in Houston Jan. 24-25. Watch the weekly Viewpoint e-newsletter for information.

Fort Worth is the site for the 2020 Annual Meeting of Members and Board of Directors Meeting, June 26-27. There will be speakers, ideas and connections to ignite your career. Plan to be there!

2019 FEDERAL TAX UPDATE CPE



Next year's tax preparation season is just around the corner! Make sure you're ready by attending TXCPA's 2019 Federal Tax Update programs. You'll cover tax law changes and hear a detailed analysis of how the new laws will affect your clients.

These one-day, eight-hour seminars are $199 for TXCPA members and will be taught by Ron Roberson, CPA. He has more than 20 years of experience teaching on the latest business and personal tax law developments. He'll include real-life examples to make tax issues come alive and help complicated subject matter make more sense.

Don't miss out! Register today.

Individuals
Dallas - October 23, 2019
San Antonio - October 25, 2019
Houston - November 22, 2019

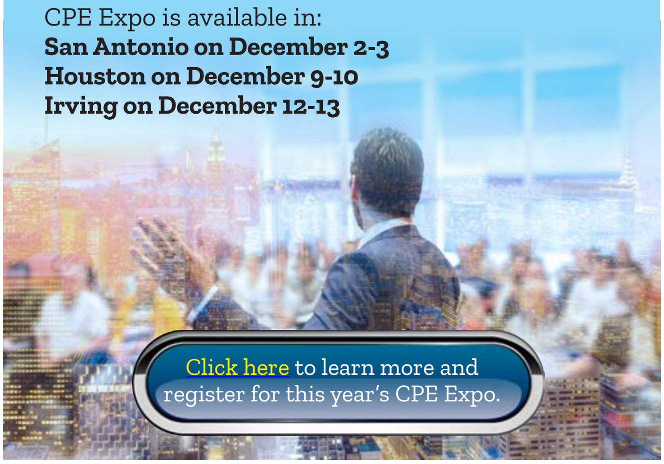
Corporations and Partnerships
Dallas - October 22, 2019
San Antonio - October 24, 2019
Houston - November 21, 2019

Don't Miss CPE Expo!

Three cities, three educational tracks, two days of top-quality CPE - it must be TXCPA's annual CPE extravaganza! Yes, CPE Expo is back in three cities across Texas! You can choose three educational tracks, including a new track developed exclusively for **young CPAs and emerging professionals.**

What better way to finish out 2019 than earning up to 20 CPE hours during sessions that cover a variety of timely topics.

CPE Expo is available in:
San Antonio on December 2-3
Houston on December 9-10
Irving on December 12-13



The CPE Value Conference Offers a Great Deal for Members

At TXCPA, we help you stretch your CPE dollars a little further! Our popular Value Conference gives you the opportunity to earn NINE hours of CPE for a fantastic rate of only $150 ($275 for non-members).

Join us in Fort Worth on October 21 and Austin on October 28 for sessions on:

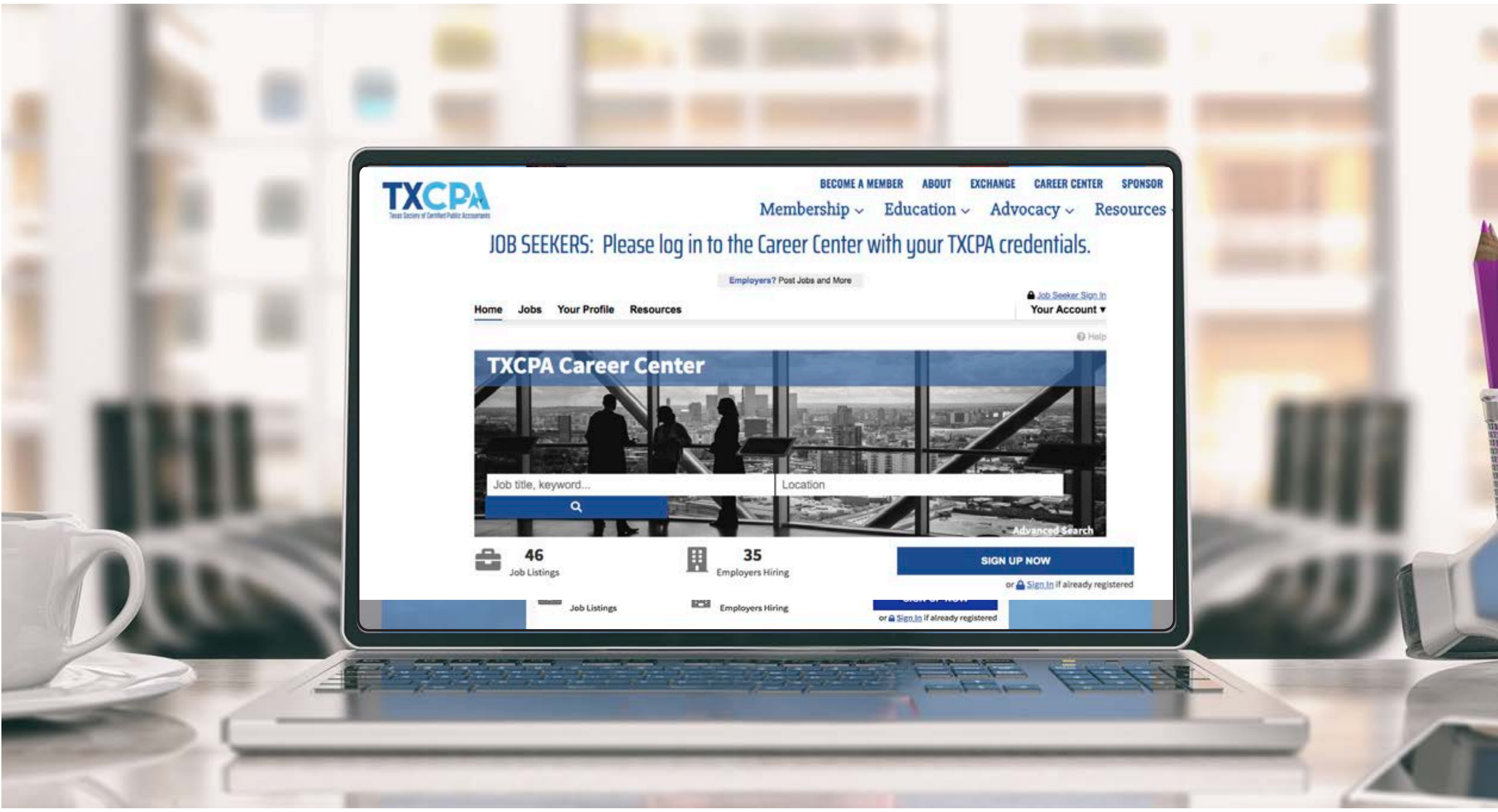
- Investing in today's environment
- Regional economic update
- Cybersecurity
- Digital ledger technology and more!

REGISTER NOW for the conference in Fort Worth or Austin. It's a CPE value that's so good, you won't want to pass it up!

TIME TO MAKE A MOVE?

LOOKING FOR YOUR NEXT SUPER HIRE?

Turn to TXCPA's Career Center!



With job postings aimed specifically at accounting and finance professionals, TXCPA's Career Center is a go-to resource for finding your perfect job. Employers love the member savings on postings and the enhanced visibility of their postings for CPA job seekers.

Visit careers.tscpa.org today!

BEFORE AND AFTER: PASS RATES AND THE NEW CPA EXAM

By Noah Kinghorn; Kelsey R. Brasel, Ph.D., CPA; and Jason Stanfield, Ph.D., CPA

The Uniform CPA Examination®

In April of 2017, important changes were implemented to the Uniform CPA Exam, including greater emphasis on task-based simulations and higher-order critical thinking skills. These changes were announced by AICPA on Sept. 1, 2015, to reflect the continuing evolution of the accounting profession.

As changes in the business world impact the profession, in conjunction with the advancement of technology, employers are expecting today's newly licensed CPAs to demonstrate a higher-order skillset to perform more difficult tasks earlier in their careers. To meet this need, AICPA determined that the Uniform CPA Exam must test these higher-order skills, which are needed immediately in the workplace (AICPA 2017b). The changes are important to uphold the public's continued trust in a CPA's technical knowledge and professional judgment.

A brief overview of the changes is presented in this article. For a more thorough examination of the revision process and the updated Exam, please see the September/October 2016 *Today's CPA* article titled "The Only Constant is Change: Upcoming Changes to the Uniform CPA Exam." The purpose of this article is to explore changes in pass rates in the first eight quarters following revision of the Uniform CPA Exam.

While the subject matter and content of the 2017 CPA Exam reflects some of the change, the primary change relates to the increased level at which the matter is tested (Rogers CPA

Review 2017a). The purpose of the changes is to ensure that the Exam tests the skills that newly licensed CPAs must possess to continue to protect the public interest. These skills include:

- Critical thinking and problem-solving,
- Professional skepticism,
- Effective communication skills,
- Well-developed research skills,
- A strong understanding of the business environment and processes, and
- Ethical and professional responsibilities.

Approximately 600 representative tasks are identified as critical to a newly licensed CPA's role in protecting the public interest (AICPA 2017b). The representative tasks combine both the applicable content knowledge and skills required in the context of the work of a newly licensed CPA[1]. The appropriate skill level is identified using Bloom's Taxonomy, based on the nature of the assigned task.

The first skill level defined in Bloom's Taxonomy focuses on remembering and understanding. Specifically, this skill requires the perception, comprehension and retention of the significance of an area using learned knowledge. The second skill level is application, requiring not only recall, but use or demonstration of knowledge, concepts or techniques. At the third skill level, analysis, each applicant is tested on his/her ability to conduct examination and study of the interrelationships of separate areas to identify causes and find evidence to support inferences. The highest skill level in Bloom's Taxonomy is evaluation, the assessment of problems and the use of informed judgment to draw conclusions.

SKILL LEVELS IN BLOOM'S TAXONOMY
1. Remembering and Understanding
2. Application
3. Analysis
4. Evaluation

While the previous version of the Uniform CPA Exam was primarily designed to test the lower-level skills of remembering and understanding with some attention paid to application, today's Exam places more emphasis on assessing higher-order skillsets, such as application, analysis and evaluation. The skills of remembering and understanding are still tested, but less explicitly, as these higher-level skills require retention of appropriate knowledge.

Each of the four examinations demands higher-order skills than previous versions. With the changes, the:

- Audit and Attestation (AUD) section now contains analysis skill-testing consisting of approximately 15-25% of the section; evaluation skills are tested in 5-15% of the content.
- Business Environment and Concepts (BEC) section includes analysis skill testing, which includes approximately 20-30% of the content.
- Financial Accounting and Reporting (FAR) section tests application skills at approximately 50-60%, with analysis falling to 25-35%, and remembering and understanding skills falling to 10-20%.
- Regulation (REG) section also increased the testing of application skills to 50-60%, with analysis, remembering and understanding each falling to between 15-30%.

AICPA also incorporated a new type of Task-Based Simulation (TBS) called Document Review Simulation (DRS). DRS is tested on the AUD, REG and FAR sections of the Exam. DRS tests candidates' application skills and then progresses to test evaluation and analysis skills.

The purpose of the DRS is to increase the authenticity of the Exam by testing real-life tasks performed by a CPA. Candidates will be required to reference documents, such as legal letters, phone conversation transcripts, and authoritative literature to differentiate between important and unimportant information.

Do Higher Expectations Mean Lower Pass Rates?

The perceived degree of difficulty is important to candidates, employers, clients and regulators, and will continue to be tested as the Exam evolves. To be certain that the changes implemented do not have a negative effect on the public trust of the accounting profession, the CPA Exam must certify that all passing applicants possess the skills and knowledge required of entry-level CPAs.

Given the focus on higher-order skills in the 2017 quarter 2 revision, many in the profession predicted a significant drop in pass rates in the period following adoption. On the other hand, some asserted that candidates might perform better, with greater emphasis on higher-level thinking skills and less on the memorization of a broad base of accounting information.

To answer whether the pass rates increased or decreased after the 2017 revision, we obtained passing rate data from 2006 through 2019 from the AICPA website (AICPA 2017c) and present the results in linear charts in Exhibits 1 through 5. A passing score requires the applicant to obtain a total reported score of 75 to pass each section (AICPA 2017d). Section scores are reported on a scale that ranges from 0 to 99.

It is important to note that this score is neither a percentage correct score nor can it be interpreted as a percentage. The total scores in the AUD, FAR and REG sections are weighted combinations of scaled scores from MCQs and TBSs. The BEC section contains a weighted combination of the scaled scores from MCQs and TBSs, as well as scaled scores from written communication tasks. These scaled scores on the MCQ and TBS portions of the exam are calculated using formulas that consider factors such as the relative difficulty of each question and whether the question was answered correctly.

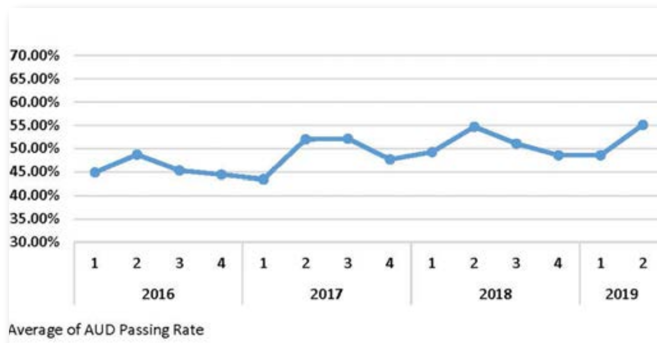
The results in Exhibits 1 through 5 report the percentage of candidates in each period (year for Exhibit 1 and quarter for Exhibits 2 through 5) who achieved a score of 75 or higher.

Exhibit 1 depicts the cumulative historical passing rates by section. The AUD, FAR and REG sections follow a fairly steady trend throughout the years hovering between 45% and 50% of candidates passing the Exam. This trend began in 2007, as this was the first year for any of the sections to jump above 45% of candidates passing.

One interesting trend is the increase in the BEC section passing percentages starting in 2012. The historical trend shows that the BEC section has the highest passing rate among all four sections both before and after the 2017 Exam revision. With eight quarters of data available, we focus on the trend and most recent quarters' pass rates for each of the four Exam parts in Exhibits 2, 3, 4 and 5.

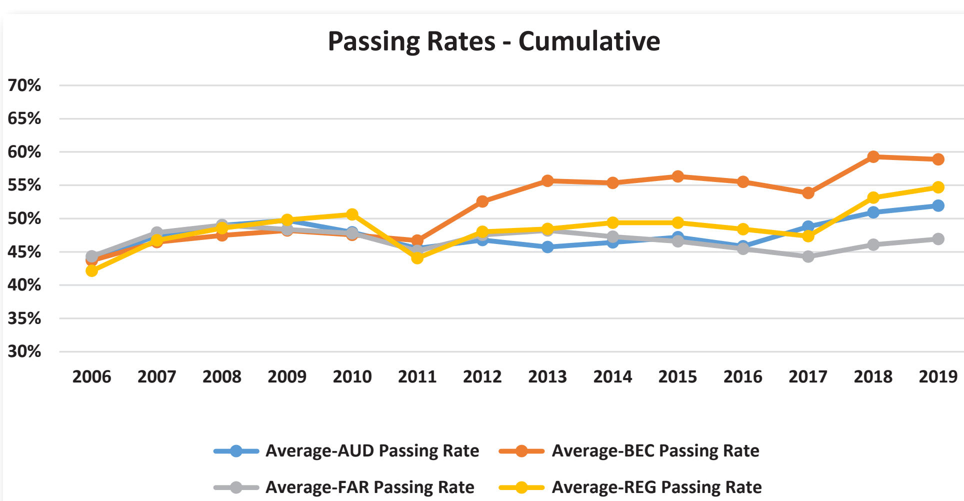
Exhibit 2 displays the historical trend of passing rates as they relate to the AUD section. In recent years, the AUD section has had one of the lowest passing rates. Through 2007 to 2010, the AUD section was among the highest passed sections, consistently reporting numbers near or above 50% of candidates passing; however, this changed in 2011 when additions such as TBSs were introduced. Passing rates for the AUD section after the 2011 changes dropped below 50% of candidates passing.

Exhibit 2 – AUD Pass Rates by Quarter



This is a graphical representation of the national passing rates for the AUD section by quarter for 2016 through 2019 (Q2). The revision became effective for all exams in Quarter 2 of 2017.

Exhibit 1 – Historical Cumulative Pass Rates Since 2006

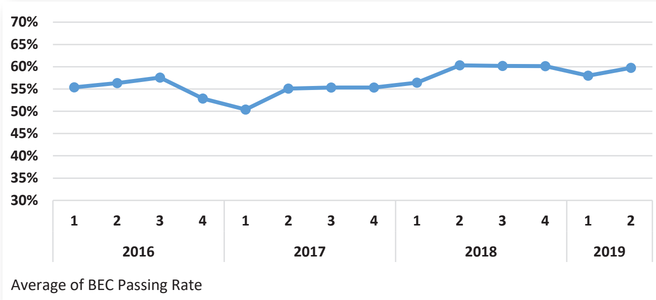


This is a graphical representation of the cumulative national passing rates for all sections from 2006 through 2019 (Q2).

However, with eight quarters of data after the Exam rewrite, the pass rate has notably risen. The 55% pass rate for the second quarter of 2019 is the highest pass rate since at least 2006. The pass rate fell somewhat for the third quarter of 2018, but increased during the second quarter of 2019, where it remains well above prior benchmarks more than a year after the revisions.

Exhibit 3 graphs the historical trend of passing rates for the BEC section. As discussed earlier, the BEC section has

Exhibit 3 – BEC Pass Rates by Quarter

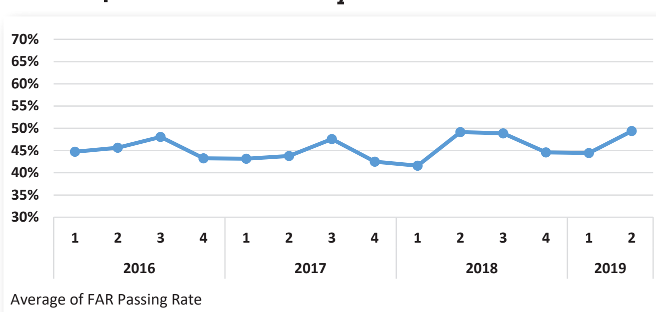


This is a graphical representation of the national passing rates for the BEC section by quarter for 2016 through 2019 (Q2). The revision became effective for all exams in Quarter 2 of 2017.

the highest passing rate percentage in recent years. The data shows an upward trend in the rates, with the largest increase occurring after the 2011 changes. Rising from 47% in 2011 to 52% in 2012, the BEC section continued its increase through 2013 to 2016, as its passing rate rose to above 55% all four years, becoming the only section to reach this mark. The data shows the 2017 changes leave the pass rate well above the other exams, hovering around 60% through the second quarter of 2019.

Exhibit 4 displays the historical trend of passing rates as they relate to the FAR section. By examining the data from 2006 through 2017, the FAR passing rates seem to follow a steady trend of about 48%, with performance peaking in the second and third quarters as recent graduates take what many consider the most difficult of the four exams. This trend persists into the most recent eight quarters, with a slight overall change in pass rates quarter over quarter, but much less noticeable of those for AUD and BEC.

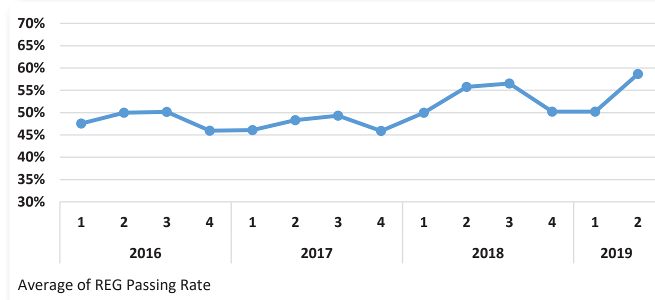
Exhibit 4 – FAR Pass Rates by Quarter



This is a graphical representation of the national passing rates for the FAR section by quarter for 2016 through 2019 (Q2). The revision became effective for all exams in Quarter 2 of 2017.

REG passing rates are depicted in Exhibit 5. After a steady climb in passing rates from 2006 through 2010, passing rates for REG dropped significantly after the 2011 change. However, in the following years, the rates recovered and look consistent with the trend before the 2011 changes, averaging near 48% throughout the years under examination.

Exhibit 5 – REG Pass Rates by Quarter



This is a graphical representation of the national passing rates for the REG section by quarter for 2016 through 2019 (Q2). The revision became effective for all exams in Quarter 2 of 2017.

The drop in 2011 reduced the cumulative passing rate for the REG section to below 45%, the first time the section had dropped that low since 2006. Following the revision in 2017, REG pass rates appear to dip slightly before climbing to over 50% in 2018, a height not seen since 2010. The increase peaks in the available data at 59% for the second quarter of 2019. It's possible that candidates may have been highly motivated to pass REG prior to the Tax Cuts and Jobs Act of 2017 (TCJA) becoming testable for examinations in 2019, partially explaining the increase.

Long-term Impact

With just over a year of testing events occurring since the revised Exam's implementation, it is impossible to predict the long-term ramifications on pass rates. AICPA's scoring system and constant content revisions virtually guarantee pass rates will continue to vary. However, with eight quarters of data to compare, overall, only FAR demonstrates any decrease in pass rates and this decline appears to have been reversed with higher performance by candidates in recent quarters.

For AUD, BEC and REG, the focus on higher-order skills appears to benefit candidates overall, with marked increases in performance apparent for each of these parts. As a new generation of CPAs is less a repository of information than skills, candidates rising to the challenge of application, analysis and evaluation provide a bright horizon for the accounting profession.

About the Authors:

Noah Kinghorn is a graduate assistant for the Paul W. Parkison Department of Accounting at Ball State University. Kinghorn is currently completing his Masters of Accounting degree and will begin his career with EY in Indianapolis in the fall of 2019. He can be contacted at **nkinghorn@bsu.edu**.

Kelsey Brasel is an associate professor in the Paul W. Parkison Department of Accounting at Ball State University. Brasel is a licensed CPA in the states of Wisconsin and Indiana. She can be contacted at **krbrasel@bsu.edu**.

Jason Stanfield is an assistant professor in the Paul W. Parkison Department of Accounting at Ball State University. Stanfield is a licensed CPA in the state of Indiana. He can be contacted at **jwstanfield@bsu.edu**.

References:

AICPA:
"The Uniform CPA Examination: Purpose and Structure." (2017a) Web. 9 September 2017. Available at: **http://www.aicpa.org/BECOMEACPA/CPAEXAM/EXAMOVERVIEW/PURPOSEANDSTRUCTURE/Pages/default.aspx**

"Uniform CPA Examination Blueprints – Effective April 2017." (2017b) Web. 9 September 2017.

"CPA Examination Passing Rates" (2017c). Web. 12 September 2017.

"How is the Uniform CPA Examination Scored?" (2017d) Web. 29 September 2017.

Roger CPA Review:
"2017 CPA Exam Changes." (2017) Web. 10 September 2017. Available at: **https://www.rogercpareview.com/cpa-exam/changes**

----

[1]This includes tax preparation services, preparing financial statements, budgeting services and several audit/assurance services provided to clients.

HOW TO VALUE PRIVATELY HELD PROMISSORY NOTES

By Bruce A. Johnson, ASA

Promissory notes are commonly used for the transfer of wealth between family members or their legal entities, like trusts, limited partnerships and corporations. Sometimes, these notes are issued to make a loan to a son or daughter to buy real estate or to fund a business start-up.

However, many of these notes originate from the sale of company stock or limited partnership interests to a younger generation. This sometimes occurs when the parents want to transfer ownership of their business, but also want to replace dividend income from the business with interest income from a note.

Another type of transaction using notes occurs when the parents have used up their one-time exclusion amount, but still have additional ownership in their business to transfer. This transfer can be accomplished by a sale from the parents to their children who issue a note in return. In other instances, siblings or trusts may desire to transfer assets between entities and notes are used in these transactions.

If the transaction is a gift or the note becomes an asset in an estate, the note must be valued at fair market value (FMV). We know that the IRS definition for FMV, as stated in Revenue Ruling 59-60, is:

> … the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts.

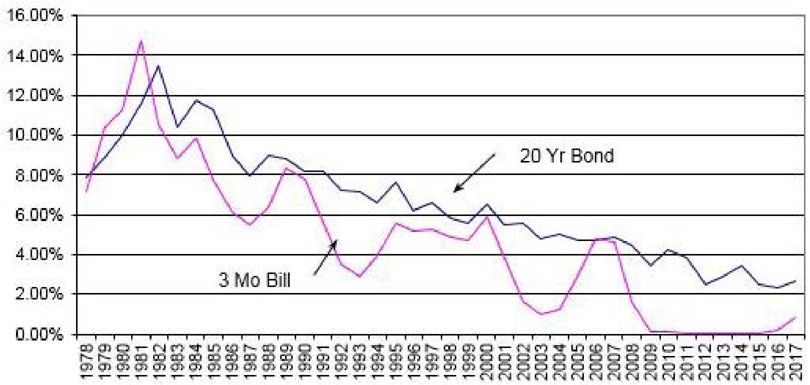
With regard to FMV, it is important to note:

> In most interpretations of fair market value, the willing buyer and willing seller are hypothetical persons dealing at arm's length rather than any "particular" buyer or seller. In other words, a price would not be considered representative of fair market value if influenced by special motivations not characteristic of a typical buyer or seller.[1]

When it comes to valuing a note, the key factors that impact the value are the stated interest rate and the amortization schedule of the note. A note with a below market interest rate would sell at a discount from its balance just like bonds trade in the public market. Therefore, a buyer would want to purchase a note at a discount from the balance to increase the interest rate of the note to a market rate. When examining the amortization of the note, notes that are interest only or that don't mature for 30 years are more risky than short-term notes, because the buyer will not receive his/her return of principal for a long time.

Just like a publicly traded bond, investors require a higher rate of return for a long-term note, because they are exposed to more risk over the life of the loan. As shown in Figure 1, rates on long-term bonds are typically higher than those of short-term bonds, since an investor is exposed to more risk over longer periods of time and, therefore, requires a higher rate of return. The same holds true for privately held promissory notes.

Figure 1. Long-Term vs. Short-Term Bonds



Other factors like collateral, payment history, marketability and the note covenants are also important to determining the value.

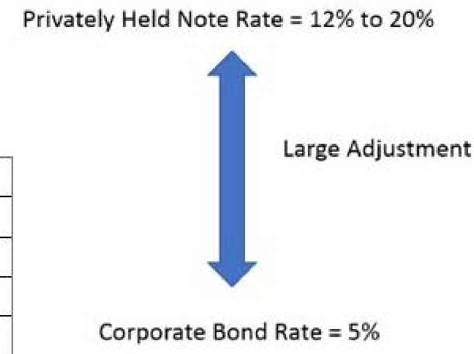
Market Rate of Interest

As one example, if the initial interest rate for a note is low compared to market rates, and the note is small and has poor collateral or a sporadic payment history, the FMV of this privately held promissory note is typically less than its outstanding balance (i.e., a buyer would discount the current balance of the note to increase its rate of return to offset the risk of the note). Therefore, a primary component of calculating the FMV of a note is to determine an appropriate market rate of interest.

At a minimum, the IRS stipulates that an interest rate called the Applicable Federal Rate (AFR) be used for loans between related parties. However, these rates are typically low compared to a market interest rate for a privately held investment. For example, the AFR ranged from 2.7% for a short-term note to 4.3% for a long-term note as of the date of this article. These rates approximate the Moody's AAA rates for corporate bonds, which is the highest bond rating and is awarded to the safest bonds of large publicly held companies.

In real world transactions, interest rates for small privately held notes typically range from 12% to 20%. (See Figure 2.) This large gap requires appraisers to make large adjustments if they use corporate bond interest rates as their basis when valuing privately held notes. Many times, this adjustment can be two or three times the original corporate bond rate.

Figure 2. Rates



As can be surmised, for privately held notes that are not comparable to corporate bonds, the large adjustments represent too large of a leap of faith to objectively value a privately held note. Considering the disparity between the AFR and real-world rates, appraisers should attempt to identify the most appropriate guideline data that is comparable to privately held promissory notes to determine an appropriate market rate of interest.

Corporate Rates Generally Not Applicable

In the past, appraisers used corporate bond rates to value privately held notes, because no other information was thought to be available. A constructive comparison to express this point might be to look at how business appraisers value operating companies. If a privately held company is large enough, appraisers use pricing multiples (i.e., P/E Ratio) to value a privately held company by comparing publicly traded companies to the subject privately held company.

However, if the private company is small and not geographically diversified, the use of the market approach is not applicable, because publicly traded companies are too big and diversified, even though they are in the same line of business. For example, it would be incorrect to use Home Depot or Lowes to value the stock of a local hardware store. This analogy is true for small privately held notes. These types of notes are not like corporate bonds issued by Home Depot, GE and Dow Chemical that have interest rates between 5% to 8%. A third-party buyer of a privately held note would require an interest rate of

12% to 20% to reflect the true risk of the investment. The following discussion represents a method for determining and applying an appropriate market rate in the valuation of a privately held promissory note.

Mechanics of the Valuation

The task of a business appraiser when valuing a privately held note is twofold. First, they must determine a market rate of interest based on the risk of the note and, second, they must calculate the present value of the future principal and interest payments of the note using its expected amortization.

Let's look at an example of a privately held note exchanged between family members for the purchase of a limited partnership interest with an initial balance of $400,000 at an interest rate of 3% for a term of five years. The terms are:

Original Balance = $400,000
Interest Rate = 3%
Term = 5 years until maturity
Annual P&I Payment = $87,342
Valuation Date = January 1, 2019

The loan is not personally guaranteed, but is collateralized by the limited partnership interest that was purchased. The schedule in Figure 3 reflects the amortization of the loan.

Figure 3. Amorization of Loan

Original Balance $400,000
Interest Rate 3.0%

	Year 1	Year 2	Year 3	Year 4	Year 5
Beginning Balance	$400,000	$324,658	$247,056	$167,126	$84,798
P&I	$87,342	$87,342	$87,342	$87,342	$87,342
Interest	$12,000	$9,740	$7,412	$5,014	$2,544
Principal	$75,342	$77,602	$79,930	$82,328	$84,798
Ending Balance	$324,658	$247,056	$167,126	$84,798	$0

The first step is to determine a market rate of interest, which consists of two components – an appropriate base rate and a specific risk premium based on an analysis of the risk of the promissory note, which includes evaluating horizon risk, payment history, amortization structure, default provisions, personal guarantees, collateral and marketability. When added together, these two components derive a market rate of interest for a note.

Since a hypothetical buyer has many alternative investment choices, it is important to base any rate of return analysis on measurable alternative investments with comparable levels of risk. Instead of using corporate bonds, a better comparison is to examine the yields of publicly traded Business Development Companies (BDCs) as an alternative investment. BDCs are typically formed as closed-end registered investment companies and provide financing to small and medium-sized privately held businesses.

The assets of BDCs are primarily comprised of a diversified portfolio of senior secured, second lien and mezzanine debt from privately held entities. Selected BDCs specialize in a specific industry, but the larger funds represent a well-diversified portfolio of debt securities.

BDCs were created by Congress in 1980 to encourage the flow of public capital to small and medium-sized private businesses in the United States. Typically, BDCs lend to small and medium-sized private companies that carry a rating of BBB- by Standard and Poor's. There are multiple shareholder protections and government compliance regulations that a BDC must meet. BDCs:

- are exempt from corporate income taxes as long as they pay out at least 90% of their taxable income back to shareholders in the form of dividends.
- are required to file quarterly and annual reports with the SEC and have restrictions on the amount of debt they can hold.
- cannot invest more than 25% of the value of their assets in the securities of one issuer.
- must comply with the Sarbanes-Oxley Act, the Dodd-Frank Act and the Investment Company Act of 1940.
- must place their securities in the custody of a bank or be subject to an additional audit and certain operational procedures to protect investors.
- must maintain a bond from an insurance company to protect shareholders from fraud or embezzlement.

There are both publicly traded and non-traded BDCs. As of the date of this article, approximately 45 BDCs were actively traded in the public market. Their current market yields ranged from a low of 7% to as much as 16%. The internal lending rates for collateralized loans of publicly traded BDCs typically range from 9% for larger companies to 15% for smaller companies. The lending rates of non-traded BDCs can be as high as 20% for short-term loans with personal guarantees.

Publicly held BDCs are listed on either the NASDAQ or NYSE, must comply with the corporate governance standards of the exchanges and are subject to regulatory exams by the SEC.

The current market yield of BDCs, or their internal lending rates, can be used as a starting point (base rate). For purposes of determining an appropriate market rate of interest for our example of a privately held note, the current market yield of the five largest publicly traded

BDCs was used to determine a base rate. The five largest BDCs and their current yield are shown in Figure 4. As reflected, the average annual yield was 10.4%.

Figure 4. BDC Chart

5 Largest BDCs	Ticker	in millions NAV	1/1/2019 Price	Annual Dividend	Yield
Ares Capital Corp	ARCC	$7,320	$15.58	$1.54	9.9%
Apollo Investment Corp	AINV	$4,170	$12.40	$1.20	9.7%
Prospect Capital Corp	PSEC	$3,430	$6.31	$0.72	11.4%
FS KKR Capital Corp	FSK	$2,070	$5.18	$0.66	12.7%
Main Street Capital Corp	MAIN	$1,510	$33.81	$2.85	8.4%
				Average	10.4%

Next, a specific risk premium is added to the base rate to determine a market rate of interest. Specific risk premiums for financial investments usually range from 2% to 6% and compensate an investor for the additional risk factors that are not reflected in a publicly traded alternative investment.

The addition of a specific risk premium is based on the premise that as the risk of an investment increases, the required rate of interest will also increase. The following factors should be considered when determining the specific risk premium.

1. Horizon Risk – Long-term notes require higher interest rates than short-term loans, since the buyer of a long-term note would be exposed to changes in micro and macro economic factors over the holding period of the note. In our example, the five-year term was considered a long-term note, so the risk of the investment is increased.

2. Payment History – Notes with a history of on-time payments are less risky than notes with no payment history or notes that are in default. In our example, this is a new note with no payment history. Therefore, the risk is increased for this factor.

3. Amortization Structure – A note with a large balloon payment might be considered to reflect more risk, due to the uncertainty of the ability to pay the balloon payment or be refinanced. Similarly, an interest-only note or zero coupon style note is more risky than a note that makes regular interest and principal payments. In our example, the note's amortization is simple principal and interest payments. Therefore, the risk is not increased for this factor.

4. Protective Covenants – The provisions of a note should allow the holder to take legal action in the event of default in order to take possession of the collateral. Notes without strong protective covenants would be considered more risky. In our example, the note agreement is well written and protects the note holder in case of default. Accordingly, the risk was not increased for this factor.

5. Collateral – Notes that are sufficiently collateralized by real estate or other tangible assets are less risky than uncollateralized notes. An uncollateralized privately held note would be difficult to sell to a third party. In our example, the note is collateralized by a limited partnership interest. This issue requires an analysis of whether the limited partnership interest sufficiently collateralizes the note and whether it could be recovered and sold upon foreclosure to pay off the indebtedness. In this case, no increase in the risk was deemed warranted.

6. Personal Guarantee – Bank loans typically require a personal guarantee by the issuer. The net worth of the issuer is important in gauging the impact of the personal guarantee on the risk of the note. In our example, the note is not personally guaranteed. Therefore, the risk of the note was increased for this factor.

7. Marketability – Unlike a publicly traded bond, a privately held note would take time to sell to a third party or interested investor. Since our note in the example is privately held, the risk of an investment would be increased due to its lack of marketability.

As mentioned previously, a specific risk premium can range from 2% to 6%, but can be higher. In this example, a specific risk premium of 4% was determined to be reasonable based on the above factors and was added to the base rate derived from the BDC's average current yield of 10.4% to calculate a market rate of interest. In this example:

Base Rate	10.4%
Incremental Risk	4.0%
Market Rate of Interest	14.4%

Based on discussions with professionals who buy and sell notes, the market rate of return for a privately held note typically ranges from 12% for a well collateralized note with a strong payment history to 25% for an uncollateralized note. For our example, the market rate of interest of 14.4% falls within this range based on the risk analysis discussed above.

Calculation of Value

The final step of the calculation is to forecast the future interest and principal payments and determine their present value using the market rate of interest determined based on the above factors. As reflected below, the

It is important to remember that it is the risk of the note (reflected in the market rate of interest) that ultimately impacts the value of the note.

Figure 5. Present Value Calculation

Market Interest Rate = 14.4%

	Year 1	Year 2	Year 3	Year 4	Year 5
Cash Flow Forecast	$87,342	$87,342	$87,342	$87,342	$87,342
Net Present Value	$296,992				

principal and interest payments are forecast to be $87,342 for each of the next five years based on the terms of the note. Discounting the future principal and interest payments to present value using the market rate of interest of 14.4% results in a value of $296,992.

The market value represents a 25.8% discount from the balance of $400,000 [1 – ($296,992 ÷ $400,000)].

Key Issues to Consider

This article discussed the key issues to consider when valuing a privately held promissory note. Even though the taxpayer and the IRS are primarily concerned with the discount from the note's balance, it is important to remember that it is the risk of the note (reflected in the market rate of interest) that ultimately impacts the value of the note.

Ultimately, the discount is the result of the calculation of value and not the driving factor. Some notes will trade at large discounts and some notes will trade at small discounts. This is a function of risk and return.

So, when conducting or reviewing a note appraisal, the reasonableness of the result should not be measured by the discount. Instead, the market rate of interest should be the measure of reasonableness and should be adjusted to an appropriate market rate by considering the risk of the investment from the viewpoint of a third party.

About the Author:

Bruce A. Johnson, ASA, is a partner in the business valuation firm of Munroe, Park & Johnson, Inc. located in San Antonio, Texas. He may be contacted at **bruce@mpjonline.com**

[1]Shannon Pratt, Valuing a Business, 3rd ed., (Homewood, IL: Richard D. Irwin, Inc., 1996), 24.

FEATURE

PLANNING FOR PRIVACY IN A PUBLIC WORLD

By Jeffrey D. Chadwick and Jordan M. Ware

We live in a public world, where anyone with a computer, smartphone or tablet can easily access an unsettling amount of our clients' personal information in a very short amount of time. Clients have become increasingly concerned with protecting their privacy and personal security, and often look to professional advisors for practical solutions. This article discusses several privacy planning strategies that professional advisors can recommend to their clients.

Utilizing a "Pour-Over" Will and Revocable Trust

A common technique to secure a client's privacy is to suggest that the client's core estate plan include a "pour-over" will and revocable trust, instead of a "standalone" will. A standalone will contains all the substantive provisions regarding the disposition of a client's assets. Because most wills become a matter of public record upon death, including the dispositive provisions of a client's estate plan in a will reveals potentially sensitive information to the public.

By contrast, a pour-over will simply provides that a client's assets will be distributed to the client's revocable trust upon death. The revocable trust agreement contains the substantive provisions of the client's estate plan. Although the client's will may be filed with the probate court upon death, the revocable trust should not be filed, which prevents the client's estate plan from becoming a public record.

In addition to protecting the privacy of a client's overall estate plan, a revocable trust can be an effective tool to privatize only certain portions of the plan. For instance, a client may desire to create a charitable trust upon death. In creating and administering the charitable trust, third parties may ask to view the entire trust agreement, which could contain dispositive provisions that the client does not wish to disclose.

A simple solution is to reference the creation and funding of the charitable trust in the body of the trust agreement, but include the governing provisions as a

A common technique to secure a client's privacy is to suggest that the client's core estate plan include a "pour-over" will and revocable trust, instead of a "standalone" will.

separate exhibit or even a separate trust agreement. This approach makes the charitable trust easy to amend during the client's lifetime without disturbing the other trust provisions. It should also enable the trustee to provide third parties with only the information that is relevant to the administration of the charitable trust.

If it is necessary to appoint an executor to administer a client's probate estate, most states, including Texas, will require the executor to file an inventory with the probate court. The inventory must generally identify the probate assets owned by the client at death, as well as the value of such assets. Many clients would prefer to keep the nature and extent of their assets from becoming a public record, either because of a general desire to limit disclosure of their wealth, or in an effort to prevent their survivors from becoming the target of financial overtures, scams or even theft.

To address this, Texas now permits the filing of an "affidavit in lieu of inventory," which allows the executor to prepare and send an inventory to the beneficiaries of the estate, while not actually filing the substance of the inventory with the probate court.

The more complete solution to secure a client's privacy, however, is for the client to fully fund a revocable trust during lifetime. Because the assets of a revocable trust are not part of a client's probate estate, the executor of the client's estate should not be required to disclose the trust assets on the estate's inventory. As further discussed below, a client can also fund a revocable trust during lifetime to facilitate the anonymous ownership of certain assets, such as real estate, vehicles, firearms and potentially controversial investments.

Finally, revocable trusts can better maintain a client's privacy and dignity if the client becomes incapacitated during lifetime. Typically, when a person becomes incapacitated, it is necessary for a court to appoint a guardian to care for the person's physical well-being (i.e., a guardian of the person) and to manage the person's financial affairs (i.e., a guardian of the estate). Not only is a guardianship expensive, it often requires personal information to be disclosed in court filings, which are a public record. A funded revocable trust can prevent the expense and publicity of a guardianship proceeding in the event of a client's incapacity.

If it is necessary to appoint an executor to administer a client's probate estate, most states, including Texas, will require the executor to file an inventory with the probate court.

Upon the client's incapacity, the named successor trustee can accept the trusteeship and immediately begin to manage and expend the trust assets for the benefit of the client. Even if a client's revocable trust has not been funded prior to incapacity, a financial power of attorney can give the agent authority to transfer assets to the revocable trust.

Limiting Disclosure to Beneficiaries

As advisors, we work with many clients who express a desire to limit the information made available to certain trust and estate beneficiaries. The reasoning behind the client's desire for nondisclosure may be legitimate and prudent. For example, a beneficiary may be financially immature, struggling with substance abuse, or prone to undue influence from a spouse or business partner.

Alternatively, the client may simply wish to create an irrevocable trust during lifetime to minimize transfer taxes and wants to limit the risk that the trust serves as a disincentive to a beneficiary's development as a productive, self-supporting member of society. In these instances, the client may seek to structure the trust so that it does not provide immediate financial benefits to the beneficiaries and, in some cases, so that the beneficiaries are not even aware of the trust's existence.

Some states, but not Texas, permit clients to create "silent trusts." A silent trust is an irrevocable trust, the very existence of which is kept secret from the beneficiaries. The trustee is obligated to manage the trust's assets during a specific period of non-disclosure, during which time the beneficiaries are unaware the trust exists. At some designated time in the future, the trustee may disclose the existence of the trust to the beneficiaries, who may then be eligible to receive distributions from the trust. While

Securing Third Party Confidentiality

While a client's efforts to maintain privacy can be effective, it may be more difficult to prevent the disclosure of confidential information by friends, family members, employees, caretakers and romantic partners. These individuals often possess sensitive information regarding a client's finances, health, activities and relationships.

An effective strategy to limit disclosure of confidential information is the proactive use of non-disclosure agreements or confidentiality clauses in third-party contracts. Non-disclosure agreements can be designed to secure privacy with respect to a client's personal and professional relationships, as well as mandate litigation alternatives, such as mediation and arbitration, that may avoid the public court system.

silent trusts may satisfy a client's legitimate privacy objectives, clients should proceed with extreme caution, as non-disclosure may conflict with a trustee's duty under traditional trust law to keep beneficiaries reasonably informed.

Just as a client may wish to limit disclosure to certain beneficiaries during lifetime, the client may also wish to limit disclosure upon death. The basis consistency rules enacted in 2015, however, require executors to disclose asset information to beneficiaries who historically were not entitled to receive such information. Specifically, Internal Revenue Code (Code) § 1014(f) provides that, subject to certain exceptions, the income tax basis of property acquired from a decedent shall not exceed the value of that property as finally determined for federal estate tax purposes.

Code § 6035(a), in turn, provides that an executor who is required to file a federal estate tax return (Form 706) under Code § 6018 must also furnish an "information return" to the IRS and a "statement" to the recipients of estate property that identifies the value of such property for federal estate tax purposes.

The information return required to be filed with the IRS is Form 8971. The statement required to be furnished to each beneficiary of the estate refers to a separate Schedule A to Form 8971 for each beneficiary. In most cases, the executor must file the Form 8971 with the IRS and send each beneficiary a copy of the statement within 30 days of filing the estate tax return.

From a privacy perspective, the reporting requirements associated with the basis consistency rules may raise a significant issue when administering a client's estate. Under Prop. Regs. § 1.6035-1(c)(3), "if … the executor has not determined what property will be used to satisfy the interest of each beneficiary, the executor must report on the statement for each such beneficiary all of the property that the executor could use to satisfy that beneficiary's interest." Thus, if an executor is unsure how a bequest will be satisfied under the decedent's will or revocable trust, the executor must disclose any and all property, along with its value, that could be used to satisfy such bequest.

Executors are rarely in a position to distribute the entire estate to beneficiaries within 30 days of filing the estate tax return. In situations involving feuding siblings or when an estate plan includes small gifts to various friends, family members, employees or charities, it may be inappropriate and, in some cases, dangerous to disclose the value of all estate property to all beneficiaries. Moreover, preparing and sending a statement to each beneficiary of an estate that essentially mirrors the asset information provided on the estate tax return may involve significant time and expense.

If a client wishes to make small bequests to friends, extended family members, caretakers, employees or charities, the client can engage in one or more of the following techniques to minimize the disclosure of asset information at death.

Fund Bequests with Non-Probate Assets. Perhaps the simplest technique involves designating the gift recipients as beneficiaries of non-probate assets, such as retirement plans, life insurance policies, or bank or brokerage accounts that are payable-on-death or subject to a survivorship agreement. Upon the client's death, the asset should pass directly to the gift recipient and should not be subject to the reporting requirement under the basis consistency rules.

Require Bequests Be Satisfied With Cash. If the bequests are to be made through the client's will or revocable trust, require that such bequests be satisfied with cash. An executor is not required to provide a statement to a beneficiary who will receive a cash bequest (regardless of when the bequest is satisfied), because cash is not subject to the reporting requirement under the basis consistency rules.

Utilize Multiple Funded Revocable Trusts. Another alternative is for the client to create and fund multiple revocable trusts to segregate smaller bequests from the balance of the client's estate. Specifically, the client can create one revocable trust, the sole purpose of which is to make smaller bequests to friends, extended family members, caretakers, employees, and other individuals or charities. In tandem, the client can create another revocable trust to dispose of the balance of the client's estate among children or other named beneficiaries. This structure should ensure that the beneficiaries of the "specific bequests" trust only receive asset information pertaining to that trust and not the client's other assets.

Liquidate Estate Assets to Satisfy Bequests. If a client's estate plan is not structured to avoid the reporting requirements under the basis consistency rules (i.e., if specific bequests may be satisfied in kind), the executor may preserve the client's privacy by liquidating estate assets and utilizing the cash proceeds to satisfy the bequests. Even if the executor does not satisfy the bequests by the statement's due date, the beneficiaries will not be entitled to receive a statement because their bequests will be paid in cash. Note, however, that this approach could cause gain to be recognized, which may have been avoided if the executor satisfied the bequests in kind, rather than in cash.

Borrow Cash to Satisfy Bequests. If the executor cannot liquidate estate assets to satisfy the bequests, the executor may borrow cash from a third-party lender and utilize the borrowed funds to satisfy the bequests.

Set Aside Estate Assets to Satisfy Bequests. If an executor cannot obtain cash to satisfy a bequest, consider setting aside a particular asset to fund the bequest. The executor is only required to disclose all of the estate's property if the executor "has not determined what property will be used to satisfy the interest of each beneficiary." If the executor has "determined" the estate asset that will be used to satisfy a bequest, the statement furnished to the beneficiary should only include that asset and may exclude all other estate assets.

Titling Real Estate and Other Assets

Many clients seek privacy with respect to ownership of particular assets, including real estate, firearms, artwork or other collectibles. As public access to real estate records and other information increases, titling these assets in a client's individual name may pose particular risks to a client's privacy and, in some cases, personal security.

To secure privacy with respect to a client's ownership of these assets, the client can title the property in the name of a business entity, such as a limited liability company (LLC) or a revocable trust. Both forms of ownership should provide privacy during lifetime and upon death, while also avoiding probate.

To maximize privacy, the LLC or revocable trust should have a name that is not easily linked to the client and should be managed by a third-party manager or trustee. In deciding whether to utilize an LLC or revocable trust, the professional advisor should also consider state and local disclosure requirements, eligibility for the homestead exemption and the client's asset protection goals for the property. The most appropriate ownership structure will depend on the client's objectives, as well as the jurisdiction in which the property is located.

Making Anonymous Charitable Gifts

Many clients desire to make charitable gifts anonymously to minimize future solicitations, uphold religious or philosophical ideals, place the focus on the charity or protect a client's personal security. Following are several ways to shield the client's identity from the general public and, in some cases, the charity itself.

Client Gives Directly to Charity. Generally, a public charity is not required to publicly disclose a donor's gift. While charities are required to file an annual tax return (Form 990), the IRS is required to redact substantial contributors' information, including name and address, before the Form 990 becomes public. A client seeking additional assurance that a charitable gift will not be disclosed to the public and that only a limited number of the charity's personnel will have access to the donor's information, should consider entering into a written agreement with the charity prohibiting disclosure.

Client Gives Through an Agent. Clients who wish to make a charitable gift that will be anonymous both as to the public and the charity should consider appointing an agent to make the gift. The agent would work with the charity to transfer the property and obtain the charity's written acknowledgement of the gift, which the client may use in claiming a charitable income tax deduction. To further protect the client's privacy and define the scope of the client's charitable gift, the agent may enter into an anonymous donation agreement with the charity.

Client Gives Through a Revocable Trust or an LLC. A client may use a revocable trust or LLC to make charitable gifts while protecting the client's identity from both the public and the charity. The name of the revocable trust or LLC should not be easily associated with the client, a third party should serve as trustee or manager, and the revocable trust or LLC should obtain a separate taxpayer identification number.

Client Gives to a Designated Fund at a Community Foundation. A client may make an anonymous gift to a charity by transferring property to a designated fund at a community foundation. The fund agreement will specify the name of the charity and the obligation to transfer funds to such charity. This strategy can be useful when a client wants to make a single, anonymous donation to a charity.

Client Gives to a Donor Advised Fund. If a client would like to give anonymously to multiple charities, the client should consider creating and funding a donor advised fund (DAF). Many public charities sponsor DAFs, which allow donors to make charitable contributions, receive an immediate income tax deduction and retain the right to recommend grants from the DAF over time.

When the DAF makes a distribution to a charity, the client may control the information that is provided to the charity, including withholding the name of the client and the DAF.

Client's Private Foundation Gives to a Designated Fund or DAF. A private foundation's annual tax return (Form 990-PF) must report financial information, including charitable grants and the names, addresses and contribution amounts of donors who give $5,000 or more during the taxable year. Form 990-PF must be available for public inspection. Clients who seek privacy with respect to grants made from a private foundation should consider utilizing a designated fund at a community foundation or DAF to distribute the funds to the ultimate charity. This strategy should make the charitable gift anonymous as to both the public and the ultimate charity.

Making Anonymous Political Contributions

Clients may desire to keep their political contributions confidential to minimize scrutiny from employers, business contacts or the general public, or to prevent a political candidate from being associated with an unpopular or controversial client. A client's contributions to a candidate, campaign or political action committee, however, can be easily identified by visiting the Federal Election Commission's website.

Clients seeking to privatize their political contributions should consider contributing to a social welfare organization created under Code § 501(c)(4). Although a 501(c)(4) organization is required to identify its contributors on its annual Form 990, the names and addresses of its contributors can be redacted.

A client seeking additional assurance of privacy should consider contributing funds to an LLC or revocable trust, which in turn contributes the funds to the 501(c)(4) organization.

Privacy Planning and Advice

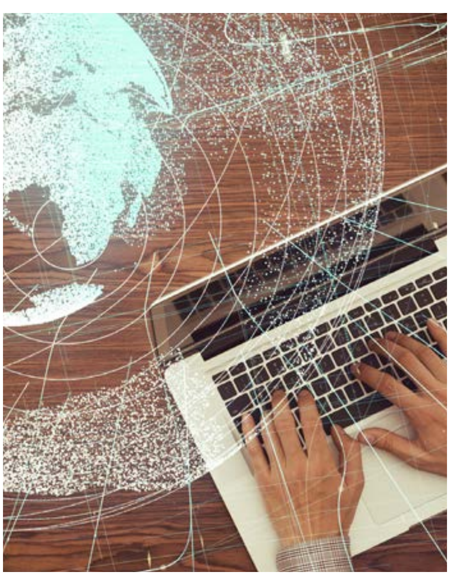
As technology continues to develop, exposing more of our client's information to public scrutiny, the importance and demand for privacy planning will only increase. While absolute privacy may be impossible to achieve, professional advisors have an opportunity to assist clients in proactively structuring their estate plans, charitable gifts and financial transactions to secure increased privacy by limiting public disclosure of sensitive information.

The strategies discussed in this article provide the professional advisor with additional opportunities to demonstrate the value-added benefit of their advice to clients.

About the Authors:

Jeff Chadwick is an attorney with Winstead PC in Houston and The Woodlands. Chadwick focuses his practice on trust and estate planning for business owners, corporate executives, professional athletes, and other high net worth individuals and families. He may be reached at 281-681-5960 or jchadwick@winstead.com.

Jordan Ware is an attorney with Winstead PC in Austin. Ware concentrates her practice on estate, business, and charitable planning and administration for high net worth individuals, executives and business owners. She may be reached at 512-370-2837 or jware@winstead.com.



Portions of this article were initially prepared for the 51st Annual Heckerling Institute on Estate Planning, sponsored by the University of Miami School of Law, and are reprinted with permission of the Heckerling Institute and the University of Miami.

---

[1]See Tex. Est. Code § 309.056.

[2]Many states have enacted silent trust statutes, with the more detailed and prominent statutes being enacted by Alaska, Delaware, New Hampshire, Ohio, South Dakota, Tennessee and Wyoming.

[3]Certain property is not subject to this reporting requirement, including cash, income in respect of a decedent, tangible personal property for which an appraisal is not required, and property sold, exchanged or otherwise disposed of by the estate in a transaction in which capital gain or loss is recognized.

[4]See Prop. Regs. § 1.6035-1(b)(1)(i).

[5]Prop. Regs. § 1.6035-1(c)(3).

[6]Texas, for example, requires LLCs to file an annual Public Information Report (Form 05-102) with the Texas Comptroller's Office, with only the names and addresses of the LLC managers required to be disclosed, and not the names and addresses of non-managing members. Revocable trusts, by contrast, generally have no associated disclosure requirements.

[7]Section 11.13 of the Texas Tax Code extends homestead protection to "qualifying trusts." Most revocable trusts can be easily structured as qualifying trusts for homestead purposes.

CPE ARTICLE

TAX TREATMENT OF A FOREIGN PARTNER'S SALE AND RELATED WITHHOLDING

By Matthew M. Mortimer

CURRICULUM: Tax

LEVEL: Basic

DESIGNED FOR: Tax practitioners; public practice

OBJECTIVES: To assist practitioners in navigating the technical issues associated with partnership tax accounting, and illustrate how to apply the new effectively connected income (ECI) characterization and related withholding rules pursuant to a nonresident partner's sale of interest in a U.S. partnership

KEY TOPICS: ECI characterization and rules established by the Tax Cuts and Jobs Act; ECI calculation processes; withholding requirements; threshold for a partner's share of effectively connected taxable income (ECTI) and net ECI gain; partnership liabilities

PREREQUISITES: None

ADVANCED PREPARATION: None

When a partner sells U.S. partnership interest, the gain is characterized and sourced as a capital asset[1], with a look-through exception for "hot assets."[2] However, since 1991, the Internal Revenue Service (IRS) has treated the sale of a nonresident partner's interest in a U.S. partnership as a sale in the interest of each underlying asset.

Revenue Ruling 91-32 (hereinafter referred to as Ruling) stated the reasoning and rules for this approach. Until recently, practitioners looked to the Ruling for guidance when characterizing the gain or loss of a nonresident partner's sale of partnership interest as effectively connected income (ECI). In July 2017, the U.S. Tax Court ruled in favor of Grecian Magnesite Mining, Industrial, and Shipping Co., which filed a tax return position contrary to the Ruling (*Grecian Magnesite Mining v. Commissioner*, 149 TC 3).

When assessing the technical merits of the IRS' position, the court found the Ruling "improperly interprets the text of relevant statutes and has inadequate reasoning"[3] and gave no deference to it. While the IRS filed an appeal for the *Grecian* decision, the Tax Cuts and Jobs Act of 2017 codified a statute in the Internal Revenue Code (IRC) similar to the Ruling in IRC §864(c)(8). Congress also introduced a withholding requirement on nonresident partnership interest sales in IRC §1446(f).

Navigating the technical issues associated with partnership tax accounting paired with the burdensome process and procedure common in international transactions is no simple task. This article illustrates how to apply the new ECI characterization and related withholding rules pursuant to a nonresident partner's sale of interest in a U.S. partnership.

ECI Characterization

In the Ruling, the IRS assesses the ECI of a nonresident partner's sale of partnership interest by using a deemed sale of the partnership's assets at fair market value. This approach is in contrast to assessing the gain or loss as the sale of a capital asset, which risked sourcing U.S.-generated gains abroad. The Ruling allocated gain or loss of ECI property in the partnership to the nonresident according to the partner's distributive share if the partnership disposed of all its assets at fair market value.[4] Net ECI gain and net non-ECI gain were computed independently as to not offset one another.

Although IRC §864(c)(8) borrowed much of its mechanics from the Ruling, there are subtle differences in the language that warrant examining the statutory ECI characterization of a nonresident's sale of U.S. partnership interest in its entirety. These rules established by the Tax Cuts and Jobs Act, P.L. 115-97, are effective for nonresident sales of U.S. partnership interest on or after Nov. 27, 2017.

When determining the ECI gain or loss pursuant to the sale of a nonresident's U.S. partnership interest, one must first calculate the gain or loss to the partnership in a deemed sale of all the partnership's assets. This is done to disaggregate the overall realized gain or loss on the sale of the partnership interest into the composite gains and losses attributable to each asset or goodwill. Then, apply the partnership's distribution rules in the partnership agreement as if apportioning non-separately taxable income.[5]

Once the partner's distributive share of the gain or loss from each deemed sale is determined, assets should be sorted into two categories: ECI and non-ECI. Source rules to determine ECI from non-ECI assets depend on the type of asset. For instance, inventories are sourced according to IRC §§861(a)(6), 862(a)(6) and 863; personal property sales are sourced under IRC §865; and U.S. real property interests are sourced as ECI under IRC §897. Income from the sale of real property interest outside of the U.S. is sourced under IRC §862.

Once the partner's distributive share of the gain or loss from each deemed sale is determined, assets should be sorted into two categories: ECI and non-ECI.

After applying the relevant IRC section to source each asset, net the gains and losses from ECI assets and net the gains and losses from non-ECI assets. Any remaining gain or loss not attributable to any of the assets, ECI or non-ECI, after the deemed sale and netting is treated as non-ECI gain or loss, as this ECI characterization is limited to the amount determined in IRC §864(c)(8)(B).[6] In following these netting rules, it is possible to have a loss on the sale of partnership interest, but still have a net ECI gain on the deemed sale of the underlying assets. The converse is also possible where a realized gain on the partnership interest sale can yield a net ECI loss.

In coordination with IRC §897, any ECI gain or loss determined in the process is reduced by ECI gains or losses attributable to U.S. real property interests, which are separately assessed and reported as ECI.[7] This is done to disallow any double benefit for U.S. real property interest loss or double taxation on U.S. real property interest gain separately assessed and reported as ECI.

For example, Partner C, of ABC Partnership, is a nonresident alien with residence in country F. ABC maintains a fixed place of business in the U.S. and Partner C is selling her 40% partnership interest to newly admitted Partner D for $150. Partner C's basis in her partnership interest is $100, so she will have a $50 realized gain. IRC §864(c)(8) characterization rules apply whether Partner D is a nonresident or not. See Exhibit 1 for the application of ECI characterization rules on the sale.

Be aware there is an anti-stuffing provision in proposed regulations that disregards property transferred into a partnership with the principal purpose of offsetting ECI gain.[8] Moreover, proposed regulations require the nonresident partner selling interest to notify the partnership within 30 days of the transfer so the partnership can provide relevant information to the selling partner by the due date, including extensions, of the Schedule K-1.[9]

Withholding on the Sale

When a nonresident engages in a taxable transaction in the U.S., the IRS is concerned about the collectability of the tax due: thus, withholding on the gross amount received by the nonresident is common practice. Unless otherwise provided in a tax treaty, withholding is often applied to dividends and interest, as well as to effectively connected income from services or U.S. real property interest. The Tax Cuts and Jobs Act introduced a new withholding requirement for those purchasing U.S. partnership interest from nonresidents in IRC §1446(f). Purchasers of a nonresident's U.S. partnership interest after Dec. 31, 2017, are required to deduct and withhold 10% of the amount realized if any of the nonresident partner's gain is treated as ECI gain under IRC §864(c)(8).[10]

Proposed regulations require the buyer to report and pay the withholding within 20 days of the transfer and

EXHIBIT 1.

	Partnership Basis	Fair Market Value	Gain from Deemed Sale	Partner C's 40% Share of Deemed Gain	ECI	Non-ECI
Cash	100	100	-	-	-	-
Net Equipment (U.S.)	50	100	50	20	20	-
Net Equipment (Abroad)	50	75	25	10	-	10
Land (U.S.)	75	100	25	10	10[a]	-
Excess Realized Gain	-	-	-	-	-	10[b]
Total	275	375	100	40	30	20

[a] Excluded from final §864(c)(8) ECI, but USRPI included as §IRC 897 ECI
[b] Total realized gain less gain from deemed sale of partnership assets

the buyer must provide a withholding certification to the partnership within 10 days of the transfer.[11] A notable statutory provision of this withholding, however, is that if the purchaser fails to withhold 10% of the amount realized, the partnership is compelled to deduct and withhold any remaining tax due (including interest) from future distributions to the purchasing partner.[12] Despite this being a statutory provision, it is suspended until the issuance of further guidance or regulations, which may be soon.[13] As of May 2019, proposed regulations for §1.864(c)(8) and §1446(f) were issued, but will not have effect until 60 days following adoption as final regulations.

Among the proposed regulations is guidance for partnerships to withhold distributions to buyers if the partnership has not received certification assuring the buyer satisfied withholding requirements.[14] Withholding is also suspended for publicly traded partnerships (PTPs) until regulations are issued.[15] However, proposed regulations include guidance for applying §1446(f) withholding to sales of PTP interest, so PTP withholding may apply soon.[16]

For illustration, when Partner D, from the previous example, completes the purchase of Partner C's partnership interest, Partner D will withhold $15 (10% of the $150 purchase price) from the sale. If Partner D fails to withhold, the partnership should be prepared to withhold the $15 plus accrued interest from future distributions to Partner D if she fails to withhold.

The withholding obligation is waived if the selling partner provides a non-foreign affidavit to the buying partner.[17] The affidavit should state the partner is in fact a U.S. person and provide a U.S. taxpayer identification number (TIN). This requirement can be satisfied with a Form W-9, provided it has the seller's name and TIN, is dated and signed by the seller, and the memorandum noting who, when and where the affidavit was signed has not been deleted.[18]

However, the waiver is disallowed if the purchaser has "actual knowledge" the affidavit is false or received a notice from an agent, of the buyer or seller, stating the affidavit is false.[19] The waiver is also disallowed if regulations require the purchaser to submit a copy of the affidavit to the IRS and the purchaser fails to do so.[20] For now, the IRS does not need to receive a copy of the affidavit,[21] but practitioners should watch for future regulation requiring purchasers to do otherwise. For guidance concerning the agents of buyers or seller and non-foreign affidavits, IRC §1445(d) is explicitly referenced and will apply in the same manner as rules for U.S. real property interests.[22]

The IRS issued interim guidance to the Section 1446(f) withholding requirement through Notice 2018-29. The Notice applies many of the rules from IRC §1445 withholding for IRC §1446(f). Primarily, until further guidance, the IRS directs taxpayers to apply the rules, regulations and forms governing IRC §1445. When withholding following the sale of a nonresident's partnership interest, the purchaser must file both a Form 8288 U.S. *Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests* and Form 8288-A *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests*. It is important to include the statement "Section 1446(f)(1) withholding" at the top of both Form 8288 and Form 8288-A to distinguish the forms from U.S. real property interest withholding.[23] Prospectively, the IRS stated its intention to modify forms, instructions and publications to more appropriately address §864(c)(8) reporting and §1446(f) withholding requirements.[24]

After requests for comments, the IRS established relief provisions waiving the withholding requirement for purchasers without non-foreign affidavits in certain circumstances. For instance, there is no withholding requirement if the seller provides certification to the buyer declaring for the three prior taxable years that the seller's allocable share of the partnership's effectively connected taxable income (ECTI) was less than 25% of the partner's total distributive share of income that year.[25] Withholding is also unnecessary if the buyer received certification from the partnership stating the net ECI gain recognized after applying IRC §864(c)(8) rules is less than 25% of the total gain on the sale.[26]

The IRS established relief provisions waiving the withholding requirement for purchasers without non-foreign affidavits in certain circumstances.

Be aware that Proposed Regulation §1.1446(f)-2 lowered the 25% threshold for a partner's share of ECTI and net ECI gain to 10% and also requires a nonresident partner's share of ECTI is less than one million dollars. Furthermore, proposed regulations introduce a "determination date" with which withholding exclusions using ECTI and net ECI gain are determined. The determination date may be the date of the transfer, any date 60 days prior to the transfer or, for non-controlling partners, the latter of the first day of the partnership's tax year or the most recent valuation of partnership assets.[27]

Other exceptions or reductions to withholding present in proposed regulations include if no realized gain occurs in a deemed sale as of the determination date, when non-recognition provisions apply, or if a tax treaty with the nonresident partner's home country reduces or eliminates withholding.[28]

Partner D will not be obligated to withhold if she received a certificate from Partner C declaring for the last three years her proportionate ECI was $20 and her proportionate share of overall partnership income was $100. The 20% ($20 share of ECI divided by $100 overall partnership income) ECTI is below the 25% threshold and Partner C's sale of partnership interest meets the relief provision in Notice 2018-29.

Also, in the first example, if the ECI attributable to IRC §864(c)(8) is only $10, instead of $20, then Partner D is exempt from withholding if the partnership provides a certificate stating the ECI from IRC §864(c)(8) is only 20% ($10 ECI from deemed sale of assets divided by $50 gain on sale of partnership interest) of the total gain on the sale. Partner D must receive either certificate within 30 days before the sale of Partner C's interest.

There is also a provision for the IRS to reduce the withholding amount from 10% if the reduced amount will not threaten the collectability of the tax arising from the ECI gain.[29] To claim this withholding relief, the buyer or seller must file a form similar to 8288-B *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*. Currently, Proposed Regulation §1446(f)-2 indicates the IRS will allow a reduction in the amount realized using Form W-8IMY, likely in the event a foreign partnership with U.S. partners sells interest in a U.S. partnership. Because U.S. residents are not subject to ECI, being taxed on worldwide income, establishing how much of the gain would be allocated to U.S. resident partners instead of nonresident partners provides relief from over-withholding.

In the sale of a partnership interest, the purchasing partner assumes the selling partner's share of partnership liabilities. Doing so is an effective additional payment to the selling partner increasing the amount realized on the sale of partnership interest beyond any cash or property transferred. Since the amount realized on the sale determines the withholding amount, the liabilities assumed by the purchasing partner can inflate the withholding amount.

Consequently, the total amount of withholding could exceed the cash or property consideration. To address this issue, the IRS will limit withholding to the amount realized reduced by the share of the partnership's liabilities assumed by the purchaser if the amount of the liabilities is known. If unknown, the maximum amount of withholding is still the amount of cash and property realized. This provision is disallowed if the purchaser is either a partner in the relevant partnership or is a related person to the seller. To apply this provision, the purchaser must check the box on line 5c of Part I of Form 8288.

Unless the transaction qualifies for any of the relief provisions previously described, buyers should plan to

report the total amount realized as subject to withholding. This number is reported on line 5b of Form 8288 and line 3 of Form 8288-A. Purchasers should also withhold 10% of the amount realized, up to the amount paid, and disclose this number on line 6 of Part I on Form 8288 and line 2 on Form 8288-A.

Summary

Although professionals have relied on guidance provided by Revenue Ruling 91-32, statutory changes from the Tax Cuts and Jobs Act justify reassessing existing ECI calculation processes when selling a nonresident's partnership interest for proper compliance with IRC §864(c)(8). Furthermore, purchasers of a nonresident's partnership interest should understand the conditions under which withholding is required and the process through which to satisfy the withholding requirements.

Both parties, and their respective agents, should remain watchful for further IRS guidance regarding partnership withholding for the purchasing partner. In addition, buyers should be prepared to utilize forms and procedures for withholding certificates, reducing the withholding requirement when available.

For now, Notice 2018-29 is the chief resource for interim guidance. The proposed regulations made slight changes to Notice 2018-29 and should be a reliable indication of the final regulations for §864(c)(8) and §1446(f).

About the Author:

Matthew M. Mortimer, Seattle, WA, is a tax associate at PwC and earned his Masters of Science in Taxation from Gonzaga University in 2019. He may be contacted at matthew.m.mortimer@pwc.us.com.

---

1 See IRC §741
2 See IRC §751
3 Grecian Magnesite Mining v. Commissioner, 149 TC, No. 3, 3, July 13, 2017
4 Rev. Rul. 91-32
5 See IRC §864(c)(8)(B)
6 See IRC §864(c)(8)(A)
7 See IRC §864(c)(8)(C)
8 Proposed Treasury Regulation §1.864(c)(8)-1(h)
9 Proposed Treasury Regulation §1.864(c)(8)-2
10 See IRC §1446(f)(1)
11 Proposed Treasury Regulation §1.1446(f)-2(d)
12 See IRC §1446(f)(4)
13 IRS Notice 2018-29 Section 11.00
14 Proposed Treasury Regulation §1.1446(f)-3
15 IRS Notice 2018-08 Section 1.00
16 Proposed Treasury Regulation §1.1446(f)-4
17 See IRC §1446(f)(2)(A)
18 IRS Notice 2018-29 Section 6.01
19 See IRC §1446(f)(2)(B)(i)
20 See IRC §1446(f)(2)(B)(ii)
21 IRS Notice 2018-29 Section 6.01
22 See IRC §1446(f)(2)(C)
23 IRS Notice 2018-29 Section 5.0
24 84 FR 21198
25 IRS Notice 2018-29 Section 6.03
26 IRS Notice 2018-29 Section 6.03
27 Proposed Treasury Regulation §1.1446(f)-1(c)(4)
28 Proposed Treasury Regulation §1.1446(f)-2
29 See IRC §1446(f)(3)
30 IRS Notice 2018-29 Section 8.0

CPE COURSE CALENDAR | OCTOBER AND NOVEMBER

For more information, number of CPE credit hours and to register, go to the CPE section of the website at tscpa.org or call the TXCPA staff at 800-428-0272 (972-687-8500 in Dallas) for assistance.

DATE	COURSE	CITY
10/4 - 5	2019 Accounting Education Conference	Austin
10/18	Financial Statement Presentation and Disclosure	Houston
10/21	Annual Update for Accountants and Auditors	Houston
10/21	FASB's Big 3 – Revenue Recognition, Leases and Financial Instruments	Dallas
10/21	CPE Value Conference	Fort Worth
10/22	Federal Tax Update – Corporations and Partnerships	Dallas
10/22	New! Accounting, Audit and Attest Update for Practitioners with Small Business Clients	Fort Worth
10/22	Fraud Update: Detecting and Preventing the Top 10 Fraud Schemes	Houston
10/23	Federal Tax Update – Individuals	Dallas
10/23	Leveraging Advisory Services to Drive Service and Revenue	Carrollton
10/24	Federal Tax Update – Corporations and Partnerships	San Antonio
10/24	Leveraging Advisory Services to Drive Service and Revenue	Austin
10/25	Advanced Tax Strategies for LLCs and Partnerships	Corpus Christi
10/25	Federal Tax Update – Individuals	San Antonio
10/25	Leveraging Advisory Services to Drive Service and Revenue	Houston
10/28	Annual Accounting Update for Accountants in Industry	Dallas
10/28	CPE Value Conference	Austin
10/30	Annual Accounting Update for Accountants in Industry	Houston
11/4	New! Help! I Don't Understand Partnerships	Houston
11/7	Handbook for Mastering Basis, Distributions and Loss Limitation for S Corporations, LLCs and Partnerships	Houston
11/8	The Complete Guide to Payroll Taxes and 1099 Issues	Houston
11/8	New! The Comprehensive 199A Pass-Through Deduction Course	Dallas
11/11	Annual Update for Accountants and Auditors	Dallas
11/11	Analytics and Big Data for Accountants	Houston
11/12	Identity Theft: Preventing, Detecting and Investigating	Dallas
11/12	Preparation, Compilation and Review Annual Update and Review	Austin
11/13	Annual Update for Accountants and Auditors	Houston
11/14	Revenue Recognition: Mastering the New FASB Requirements	Houston
11/14 - 15	Texas CPA Tax Institute	Dallas
11/14 - 15	Texas CPA Tax Institute	San Antonio
11/15	Governmental and Not-for-Profit Annual Update	Corpus Christi
11/18	New! The Comprehensive 199A Pass-Through Deduction Course	Houston
11/18	Handbook for Mastering Basis, Distributions and Loss Limitation for S Corporations, LLCs and Partnerships	Dallas
11/19	The Complete Guide to Payroll Taxes and 1099 Issues	Dallas
11/19	Preparation, Compilation and Review Annual Update and Review	San Antonio
11/20	Analytics and Big Data for Accountants	Dallas
11/21	Federal Tax Update – Corporations and Partnerships	Houston
11/22	Federal Tax Update – Individuals	Houston

Please note that when registration is complete,
a confirmation email will be sent and provide a hyperlink to access the quiz.

CPE ARTICLE: TAX TREATMENT OF A FOREIGN PARTNER'S SALE AND RELATED WITHHOLDING

By Matthew M. Mortimer

Today's CPA offers the self-study exam for readers to earn one hour of continuing professional education credit. The questions are based on technical information from the preceding article. If you score 70 or better, you will receive a certificate verifying you have earned one hour of CPE credit – granted as of the date the test arrived in the TXCPA office – in accordance with the rules of the Texas State Board of Public Accountancy (TSBPA). If you score below 70, you will receive a letter with your grade.

1. When does §864(c)(8) apply?
A. When a U.S. partner sells interest in a foreign partnership
B. When a U.S. shareholder redeems shares in a foreign corporation
C. When a foreign partner sells interest in a U.S. partnership
D. When a foreign shareholder redeems shares in a U.S. corporation

2. How is ECI calculated in §864(c)(8)?
A. Deemed sale of all partnership assets
B. Deemed sale of partnership domestic assets
C. Apportioning realized gain on sale to domestic assets
D. When the partnership liquidates upon dissolution

3. Which of the following is possible after applying §864(c)(8)?
A. Overall realized gain and net ECI gain
B. Overall realized gain and net ECI loss
C. Overall realized loss and net ECI gain
D. All of the above

4. Why is §864(c)(8) ECI gain offset by gains and losses attributable to U.S. real property interest?
A. U.S. real property interest is not subject to ECI
B. To avoid double taxation or benefit with §897
C. To increase residual non-ECI gain
D. To coordinate with the U.S. Model Tax Treaty

5. Under §1446(f), how much is the purchaser required to withhold?
A. 15% of the net gain
B. 10% of the net gain
C. 15% of the amount realized
D. 10% of the amount realized

6. Should the purchaser fail to withhold, who will statutorily be responsible to withhold?
A. The purchaser remains liable for withholding until tax is paid
B. The partnership must withhold future distributions to purchaser
C. The seller must pay estimated payments in lieu of withholding
D. No parties are compelled to withhold

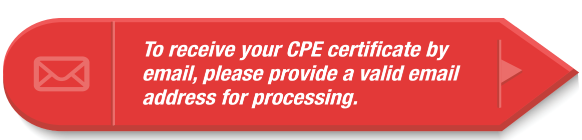
7. Among the proposed regulations is guidance for partnerships to withhold distributions to buyers if the partnership has not received certification assuring the buyer satisfied withholding requirements. Withholding is also suspended for ___________ until regulations are issued.
A. General partnerships
B. Publicly traded partnerships (PTPs)
C. Limited partnerships
D. Limited liability partnerships

8. Which of the following is not an exception to withholding (disregarding proposed regulations)?
A. Non-foreign affidavit provided to purchasing partner
B. Selling partner's ECTI for last three years was less than 25 percent of distributive share of partnership income
C. Net ECI from §864(c)(8) is less than 25 percent of the total gain on the sale
D. Selling partner is a foreign partnership with U.S. partners

9. To determine withholding obligations, proposed regulations include a "determination date" that may be:
A. The date of the transfer
B. Any date 60 days prior to the transfer
C. The latter of the first day of the partnership's tax year or the most recent valuation of partnership assets
D. All of the above

10. Partnership liabilities assumed by the purchasing partner have what potential effect on withholding?
A. Reduce the amount realized and total withholding
B. Increase the amount realized and total withholding
C. Increase the amount realized and reduce total withholding
D. Reduce the amount realized and increase total withholding

To receive your CPE certificate by email, please provide a valid email address here:



Please mail the test (photocopies accepted) along with your check to:
Today's CPA; Self-Study Exam: TXCPA CPE Foundation Inc.; 14651 Dallas Parkway, Suite 700; Dallas, Texas 75254-7408. TSBPA Registered Sponsor #260

Name: ____

Company/Firm: ____

Address (Where certificate should be mailed)

City/State/ZIP: ____

Email Address: ____

Make checks payable to *The Texas Society of CPAs*
❑ $15 (TXCPA Member) ❑ $20 (Non-Member)

Signature: ______________________TXCPA Membership No: ___________

PRACTICES FOR SALE

$650,000 gross. Santa Fe, NM firm. 84% tax, 15% accounting, 1% miscellaneous. Long-term client base. The 2 owners and 4 staff people are available to assist in transition. Contact **ssb4@nets.com**.

$400,400 gross, northwest of Houston firm. 78% tax, 22% accounting, payroll, miscellaneous. Long-term client base and expanding with new area growth. Staff in place and owner to assist w/transition. Respond to: File Box #6020, Attn: DeLynn Deakins, Texas Society of CPAs, 14651 Dallas Parkway, Suite 700, Dallas, TX 75254.

Texas Practices Currently Available
Through Accounting Practice Sales:
North America's Leader in Practice Sales
Toll Free 1-800-397-0249
See full listing details and inquire/register
for free at www.APS.net.

$1,255,000 gross. Austin CPA firm. 100% tax prep - 52% ind., 32% bus, 16% fiduciary and other. Strong cash flow 60% of gross and staff in place. TXC1070

$700,000 gross. San Antonio CPA firm. 98 1040s, 24 1120s, 148 1065s, 38 1041s, 177 franchise returns, 6 comps, 3 qrtrly p/r tax, excellent growth potential, financing negotiable. TXC1066

$1,523,500 gross. Austin CPA firm. 77% tax (47% inv., 53% bus.), 19% acctng, 4% other, turn-key practice with solid cash flow and support staff in place. TXC1068

$635,000 gross. NE San Antonio metro area CPA firm - 53% tax (56% ind, 44% bus.), 47% write-up, experienced staff and seller available for transition assistance. TXC1069

$1,255,000 gross. Austin CPA tax firm. 100% tax (52% ind., 32% bus., 15% fiduciary/other, cash flow 60%, staff in place and partners available for transition. TXC1070

$290,000 gross. E/SE Texas CPA firm. Primarily tax (70%), high-quality clientele, solid fee structure, turn-key opportunity. TXN1451

$365,000 gross. Grayson Co. CPA firm. (68%) tax, (24%) acctng, (9%) consulting, staff in place, loyal client base, turn-key opportunity. TXN1471

$475,000 gross. SW Arlington CPA firm. 55% tax, 32% acctng, 11% consulting, strong fees, quality client base, turn-key practice. TXN1474

$345,000 gross. E. Dallas suburb CPA firm. Tax and acctng nearly 50% each, loyal clients, experienced staff, turn-key practice with capacity for growth. TXN1484

$209,000 gross. NE Texas CPA firm. 70% tax, 30% acctng, ideal size for marketing-oriented buyer to tap existing client base and grow substantially. TXN1491

$640,000 gross. N. Dallas CPA firm. 56% tax, 44% acctng, experienced staff in place, strong fee structure, high-quality and diverse client base. TXN1492

$555,000 gross. Mansfield CPA firm. 50/50 tax and acctng, 70% derived from businesses, knowledgeable staff in place, turn-key practice. TXN1495

$266,000 gross. East Texas EA firm. 67% tax, 33% acctng, quality client base, experienced staff in place, turn-key opportunity. TXN1497

$364,000 gross. Hurst CPA firm. 89% tax, 11% accounting services, turn-key practice with experienced staff and primed for new owner and smooth transition. TXN1498

$240,000 gross. S. Dallas Oak Cliff area CPA firm. 50/50 tax and write up, strong fee structure, cash flow around 55%, turn-key practice. TXN1500

$488,000 gross. East TX CPA firm. Acctng 45%, tax 55%, audit/review 5%, strong fee structure and cash flow around 60%, experienced staff, turn-key and profitable. TXN1505

$525,000 gross. Northern Collin Co. CPA firm. 57% tax, 29% bkkpng, 10% payroll, 5% misc., turn-key, cloud-based operation, tenured staff and loyal client base. TXN1508

$367,000 gross. Abilene CPA firm. 65% tax, 28% acctng, 9% payroll, quality clients, knowledgeable staff in place, strong fee structure, turn-key opportunity. TXN1509

$801,000 gross. East Texas (Tyler/Longview) CPA firm. Acctng (32%), tax (47%), audits (10%), misc. (11%), loyal client base, experienced staff and strong fee structure. TXN1510

$514,000 gross. Mansfield CPA firm. Predominantly tax (95%), excellent cash flow of approx. 65%, loyal client base, strong fee structure, turn-key opportunity. TXN1511

$750,000 gross. West of Fort Worth CPA firm. Focused on high-quality tax work, solid fee structure, strong cash flow near 60%, experienced staff, turn-key opportunity. TXN1512

$687,000 gross. Fort Worth CPA firm. Tax 75%, acctng 25%, high-quality, loyal client base, somewhat portable, seller open to longer transition if needed. TXN1513

$470,000 gross. Grapevine/Southlake CPA firm. Predominantly tax, strong fee structure, excellent cash flow near 65%, tenured and knowledgeable staff, turn-key practice. TXN1514

$641,000 gross. Brazos Valley area CPA firm. Tax 65%, acct/bkkpg 32%, other 3%, excellent fee structure and cash flow, knowledgeable staff in place and seller available to help with transition. TXS1225

$305,000 gross. SE Texas CPA firm. Tax 60%, bkkpg 40%, turn-key practice with staff in place, friendly clients, owner available to assist through tax season. TXS1232

$1,811,000 gross. League City area CPA firm. Tax 53%, bkkpg 31%, consulting 16%, strong fees, sophisticated client base, excellent staff, turn-key practice. TXS1235

$200,000 gross. W. Houston CPA firm. Tax 73%, comps/reviews/single audit 23%, other 4%, prime location, staff in place, long-term and loyal client base. TXS1237

$1,147,000 gross. Spring/Woodlands area CPA firm. Tax 85%, bkkpg 13%, reviews 2%, experienced staff, turn-key office in prime location. TXS1240

$770,000 gross. N. Houston CPA firm. Tax 48%, bkkpg 38%, consulting 14%, experienced staff, sophisticated business clientele, turn-key office in prime location. TXS1241

$292,000 gross. Lubbock CPA firm. Acctng 10%, tax 90% (61% ind., 28% bus., 11% other), great cash flow over 73%, consistent annual revenues, seasonal employee. TXW1023

ACCOUNTING PRACTICE SALES
For more information, call toll free 1-800-397-0249
See full listing details and inquire/register for free at www.APS.net.

PRACTICES SOUGHT

Accounting Broker Acquisition Group
"Maximize Value When You Sell Your Firm"
You Sell Your CPA Firm Only Once!

Free Report

"Discover the 12 Fatal Errors You Must Avoid When You Sell Your Firm!"

Purchase • Sale • Merger
Texas CPA Practices

Our M&A Brokers Are 100% "Ex-Big Four" CPAs!

Call or email now for Free Report!
800-419-1223 X101
maximizevalue@accountingbroker.com
accountingbroker.com

SEEKING CPA FIRM SELLERS
ACCOUNTING BIZ BROKERS has been selling CPA firms for over 15 years and we know your market. Selling your firm is complex. We can simplify the process and help you get the best results! Is 2019 your year to sell? List now to receive your best results! Our "Six Steps to Success" process for selling your firm includes a personalized, confidential approach to bring you the "win-win" deal you are looking for. Our brokers are the only Certified Business Intermediaries (CBI) specializing in the sale of CPA firms in the nation! When you are ready to sell, we have the buyers, financing contacts and the experience to assist you with the successful sale of your firm! Contact us TODAY to take the first step!

Kathy Brents, CPA, CBI
Office 866-260-2793 Cell 501-514-4928
Kathy@AccountingBizBrokers.com
Visit us at **www.AccountingBizBrokers.com**
Member of the Texas Society of CPAs
Member of the Texas Association of Business Brokers

BUYING OR SELLING?
First talk with Texas CPAs who have the experience and knowledge to help with this big step. We know your concerns and what you are looking for. We can help with negotiations, details, financing, etc. Know your options. Visit **www.APS.net** for more information and current listings. Or call toll-free 800-397-0249. Confidential, no-obligation. We aren't just a listing service. We work hard for you to obtain a professional and fair deal.

ACCOUNTING PRACTICE SALES, INC.
North America's Leader in Practice Sales

MISCELLANEOUS

Michael J. Robertson, CPA
Texas Sales and Mixed Beverage Tax Solutions

Do you have a client with an upcoming sales tax audit or currently under audit? Does your client have a compliance issue or general question about sales tax? Call our team of sales tax experts. Our team provides over 100 years of experience with the Comptroller of Public Accounts as former auditors and supervisors. Our goal is to facilitate the audit process for your client and provide guidance as they move forward with their business.

Call 817-478-5788 or 214-415-4333
Texas Sales and Mixed Beverage Tax Solutions

Do you have questions about sales tax? Taxability issues? Audit defense? Refunds? Voluntary disclosure?

Let us be a resource for your firm and your clients. Our owner is a CPA with a BBA in Accounting and Master of Science in Taxation. He spent 10 years in public accounting, working for both national and large, local CPA firms prior to forming Sales Tax Specialists of Texas in 2005. Feel free to contact us with any questions.

Stephen Hanebutt, CPA
Sales Tax Specialists of Texas
This firm is not a CPA firm
972-422-4530
shanebutt@salestaxtexas.com

GROWTH SOLUTIONZ, AMERICA'S SMALL BUSINESS ADVISORS now awarding franchises. Have a $1 million tax accounting practice in 4 years.

Contact **CalvinBrown@GrowthSolutionz.com** or visit **www.GrowthSolutionz.com/accounting-franchise**.


TODAY'S CPA
Texas Society of Certified Public Accountants
28,000 Members. Infinite Possibilities.
Start Building Stronger Business Relationships Today.
Today's CPA provides companies with endless possibilities to grow their brands among key decision makers. *Today's CPA* reaches 28,000 members across the state and includes an audience of partners, presidents, CEOs, executives, department managers, and additional professionals with buying power and authority for a range of products and services.
Today's CPA is your best resource for reaching high-end purchasers and business advisors. All 20 local chapters and 28,000 TXCPA members throughout Texas receive *Today's CPA*. These high-level and influential readers use the magazine as a resource to live up to the highest standards of ethics and practices within the CPA profession.
AM BIZ
american business media
To learn more about *TODAY'S CPA* or to customize a marketing program unique to your business needs, call 860-719-1991 or email bdimauro@ambizmedia.


IMAGINE...
A CHAIR
WITHOUT
A DESK