

CERIFI CPE NETWORK

TAX REPORT

DECEMBER 2025

VOLUME 38, ISSUE 11

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Attention NCRPs: This course does *not* qualify for AFSP professionals requiring “Federal Tax Law Update” credits.

EXECUTIVE SUMMARY

PART 1. TAX CASES THAT WILL SAVE YOUR CLIENTS MONEY

Tax Cases that Will Save Your Clients Money 4

This course, “**Tax Cases That Will Save Your Clients Money, Give You Courage, and Protect Your Tax Practice**,” explores four pivotal court decisions that continue to shape modern tax practice—**Cohan v. Commissioner**, **Churchman v. Commissioner**, **Agarwal v. Commissioner**, and **Harary v. Blumenthal**. Each case provides enduring lessons on substantiation, profit motive, statutory interpretation, and professional ethics, offering tax practitioners valuable guidance for advising and defending clients.

The course begins with *Cohan v. Commissioner (1930)*, which established the **Cohan Rule**, allowing taxpayers to claim reasonable estimates of deductible expenses when adequate records are missing. This landmark case remains a cornerstone of audit defense and informs ethical standards on the use of client estimates, as outlined in **AICPA SSTS No. 4** and **IRC §274(d)**.

Next, *Churchman v. Commissioner (1977)* delves into the **hobby loss rules under §183**, demonstrating how a taxpayer may prove a bona fide profit motive despite years of losses. The case of Gloria Churchman—an artist who prevailed by showing businesslike conduct and persistence—clarifies that profit expectation need not be reasonable, only genuine.

Agarwal v. Commissioner (2009) expands the meaning of “real estate professional” under **§469(c)(7)**, holding that real estate agents perform “brokerage services” and qualify for non-passive treatment of rental losses. This interpretation later influenced Treasury Regulations under **§199A**, confirming that real estate agents are not “specified service trades or businesses.”

Finally, *Harary v. Blumenthal (1977)* underscores the ethical imperatives of **Circular 230 §10.22**, illustrating that honesty and due diligence are foundational to maintaining professional integrity before the IRS. Together, these cases equip practitioners with practical strategies to defend deductions, substantiate profit motives, interpret statutes, and uphold ethical conduct—essential tools for competent, compliant, and client-centered tax practice. [Running time: 49:26]

Learning Objective:

Upon completion of this segment, the user should be able to:

- Apply the Cohan Rule when preparing or defending tax returns where complete records are unavailable, consistent with ethical standards under Circular 230.
- Evaluate whether an activity qualifies as a trade or business versus a hobby by analyzing the nine IRS factors outlined in the *Churchman* decision.
- Identify the professional and ethical responsibilities of tax practitioners under Circular 230, including due diligence and honesty obligations illustrated in *Harary*.

PART 2. BUYING AND SELLING A BUSINESS

A Practitioner’s Guide to Buying and Selling a Business..... 58

This chapter provides an in-depth examination of the tax, legal, and practical considerations involved in structuring and executing the sale or purchase of a business. It equips tax and accounting professionals with the knowledge to advise clients effectively, minimize tax exposure, and manage transactional risks.

The program begins by contrasting the objectives of **buyers and sellers**—two parties with often opposing interests. Buyers seek **asset sales** to gain a step-up in basis, greater depreciation, and amortization benefits, while sellers prefer **stock sales** to realize capital gain and avoid double taxation. The course explores how these differing motivations shape deal structure and negotiation strategy.

Key transactional frameworks are covered, including **asset sales, stock sales, and tax-free reorganizations under IRC §368**. The importance of **due diligence** is emphasized throughout, addressing issues such as contingent liabilities, transferability of leases, licenses, and contracts, as well as potential state and local tax implications.

Detailed discussions of critical **Internal Revenue Code sections**—notably **§1060** (purchase price allocation among seven asset classes), **§751** (hot assets in partnership sales), and **§754** (basis adjustments for partnerships)—illustrate how tax characterization affects both parties’ results. The course also examines the **built-in gains (BIG) tax** applicable to converted S corporations and highlights the distinction between **corporate goodwill** and **personal goodwill**, referencing landmark cases such as *Martin Ice Cream Co.* to explain their tax treatment.

Through real-world examples and practical insights, participants gain the ability to identify opportunities for tax savings, properly allocate purchase price, and structure transactions that achieve clients’ financial goals while maintaining compliance with tax regulations. Ultimately, the course prepares practitioners to navigate complex transactions with confidence and strategic foresight. [*Running time: 39:23*]

Learning Objective:

Upon completion of this segment, the user should be able to:

- Differentiate between asset, stock, and reorganization transactions and explain their respective tax consequences for both buyers and sellers.
- Apply the principles of IRC Sections 1060, 751, and 754 to properly allocate purchase price and recognize income or gain in business transfer situations.
- Evaluate due diligence, goodwill considerations, and state-level tax implications to ensure accurate and compliant structuring of business sale agreements.

ABOUT THE SPEAKERS

Mike Giangrande, JD, LLM, is a California licensed attorney and has been a tax practitioner for 25 years. He is licensed to practice before the United States Tax Court, has a B.S. in Accounting and an LL.M. in Tax from Chapman University, and has a J.D. from Whittier Law School. Mike has spent time as an adjunct professor of law and he served as a member of the Orange County Assessment Appeals Board. Mike has served as the Federal Tax Editor for Spidell Publishing, LLC since 2017 and has been lecturing during that time. Mike authors many tax manuals and webinars each year.

Ian J. Redpath, JD, LLM, is a nationally recognized tax attorney and consultant from Buffalo, New York, and is a principal in the Redpath Law Office. Mr. Redpath has published numerous articles on contemporary tax issues and co-authored several books on tax topics. He has extensive national and international experience developing, writing, and presenting professional CPE programs. In addition to his active tax practice, he serves as Chairman of the Department of Accounting, Director of Graduate Accounting Programs, and Professor of Taxation and Forensic Accounting at Canisius College in Buffalo.

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Learning Objectives (Refer to executive summary)	
Program Description (Refer to executive summary)	
Instructional delivery method	Group Live
Recommended CPE credit	3.0 Credits
Recommended field of study(ies) (Refer to executive summary)	
Program Level	Update
Prerequisites (Circle One)	<ul style="list-style-type: none"> • Basic Accounting and Auditing professional experience • Basic Tax professional experience • Basic Governmental professional experience
Advance preparation	None required
Course registration and, where applicable, attendance requirements (1)	

(1) Insert instructions for your students to register for the class and any other attendance requirements (e.g., bring your laptop, be prepared to work in groups, you will be required to sign in and sign out of the session, etc.)

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—From a Declaration of Principles jointly adopted by a *Committee of the American Bar Association and Committee of Publishers and Association*

PART 1. TAX CASES THAT WILL SAVE YOUR CLIENTS MONEY

Tax Cases that Will Save Your Clients Money

In this engaging and highly practical tax ethics and case law program, we explore four landmark cases that continue to influence the way tax practitioners approach compliance, client relationships, and professional responsibility. Through an accessible and story-driven discussion, the instructor examines **Cohen, Churchman, Agarwal, and Harary**—four cases spanning nearly a century of tax law evolution. From the early lessons of George Cohen’s inadequate recordkeeping to the modern implications of Circular 230 in Harary, each case demonstrates a principle that every accountant and tax preparer must know. The video blends humor, relatable examples, and professional insight to highlight how these decisions inform our day-to-day work—from defending a client under audit to determining whether an activity is a business or hobby. This introduction sets the stage for a thoughtful journey through real-life scenarios where professional judgment, ethical responsibility, and regulatory compliance converge, reinforcing why due diligence and integrity remain the cornerstones of sound tax practice.

So, the four cases we want to talk about are Cohen, Churchman, Agarwal, and Harary. These are four cases that tackle four different topics that I think we all see on a very regular basis. And so walking through these cases, some of them very old, Cohen is over 100 years old, but it is still a very good case. Well, I guess the years at issue were over a hundred years old. The case itself is 100 years old yet, but right around there. But the issues here for Cohen, we're going to talk about how do you prepare to tax returns when you don't have perfect information? Same thing with defending them on an audit.

In Churchman, we're going to talk about hobby loss rules. Agarwal is the real estate professionals and then Harary is the tax professional who is doing very bad things with their client. And those are the cases that we are going to focus on.

So let's start with Cohen. So Cohen was decided in 1930, but the case was dealing with tax years 1921 and 1922. And, Cohen is still very much a part of our tax world because of the way it applies. Now here in this case was a case out of New York and George Cohen had his case decided by the Board of Tax Appeals, which was the predecessor to the United States Tax Court. And this case dealt with a disallowance of business expenses, like I said, for tax years 1921 and 1922.

Now a little bit of background on Mr. Cohen. He was a theatrical manager and produced plays got his start as a child actor in vaudeville with his parents and his sister and he was as you would imagine as somebody who was a very artistic type with what they referred to as free-handed in his business expenses You and I would just say this is somebody who just maintains very bad business records, spends money on meals and entertainment. Very freely, and entertainment was a very big part of his expenses which were deductible fully back in 1921 and 1922 not like today.

And he really just didn't keep any business records at all. So when he went to go file his income tax returns he simply told his tax professional at the time or his attorney whoever was preparing his tax returns. I had business expenses of \$33,000 in 1921 and in 1922 he said I had \$22,000 of business expenses. Now, to give you some context, \$33,000 in 1921 would be the equivalent of a little over \$600,000 today. And then the \$22,000 in 1922 would be a little over \$400,000 today. So quite a big dollar amount for somebody who's got no records whatsoever. Didn't keep any business records.

Now, he didn't keep any business records. He was audited by the IRS and what happened here? The IRS said, sorry, you don't have any business records. We're not going to let you have any deductions. And the board of tax appeals, remember this is the predecessor to the United States tax court, agreed and said, we are not going to let you deduct anything. You get zero business deductions despite the fact that you are running plays, you're running shows on Broadway, we all know that. We'll talk about just how many shortly. But because you don't have any records, we're giving you nothing. Nothing in the way of allowable deductions. So then the issue became here, how far is the board's refusal to allow Cohen any business expenses justified? Because the board did find that he did in fact have business expenses. And they acknowledged that his expenses were probably significant given the level of business activity he had going on and his, you know, his stature, he's somebody who has business expenses.

But they said, because you don't have any records, we're not going to allow any. Can they do that? Was that proper? And here are some key language from the case. The Cohen case, if you ever want to read it, it's actually a really good read. And it's only about four pages long. It is not a long read. But here's some of the language that the court used. The appellate court here was awesome. Second Circuit Court of Appeals. said, look, hey, absolute certainty is usually impossible and is not necessary.

Now, the board, meaning the predecessor of the tax court, can make an approximation of Mr. Cohen's expenses. They don't have to take his word for it because they can bear heavily if they choose upon the taxpayer whose inexactitude is of his own making. And I think that that is really key language for us.

When we get a client who can't remember their expenses, maybe they're a client who for some reason can't find their telephone records, but they're clearly somebody who has a telephone as a business expense. And that person just can't find them. They've got no records that they can find, but they paid their phone bill. And they say, I pay about \$500 a month, my phone. And so you say, okay, I'm going to deduct \$6,000. And then you're audited and the IRS says, well, you don't have any, you don't have any proof of payment.

You don't have any, anything here. You don't have any proof of cancelled checks whatever it is you've got. Therefore, we're going to give you no deduction and your client has proof that he's got a phone you dial it. It's going to ring. He's been using it for his business. Clearly. It's a type of business that requires a phone. Can the IRS simply say you get nothing? Here this is what the board was getting or the appellate court was getting. It was you can't say they have nothing.

You don't have to take the taxpayer at their word. The IRS doesn't have to say, the taxpayer says they spent X amount of dollars. We have to take their word for it. But they can't acknowledge that this person has a business expense. It's legitimate while at the same time allowing nothing without lost records. And for us, most of us, when we have a client like this, it's usually somebody who just can't find one thing, maybe for expediency to try to get the tax turn done and not force them to go spend hours trying to research it. They'll just give you a number they estimate.

That can happen, although it's not ideal. But I think what's more likely is you have a client whose business records are quite frankly burned up in a fire or destroyed in a flood. That client is allowed to estimate what their business income and expenses are. If they're audited, like I said, the IRS doesn't have to take their word for it for everything. But it doesn't mean that the IRS is allowed to disallow everything.

Part of the language here from the case, the court said to allow nothing at all appears inconsistent with saying that something was spent. Clearly this guy had a business and the business requires, well, expenses. Some more of language I just want to touch on. I won't touch on all of it, but here what the court says is the amount may be trivial or unsatisfactory, but there was some basis for allowing some expenses. And it was wrong of the predecessor to the tax court here to refuse any expenses.

Even though it were the traveling expenses of a single trip, right? So even if it's a single item, they can't deny it. If you can substantiate that you had some level of expenses, if you can substantiate that you had legitimate items. And then the one I want to point out on this page here is where the court says, it's not fatal that the result will inevitably be speculative because many important decisions must be such.

So for us, that should give us some comfort as practitioners that everything doesn't have to be perfect. We want our clients to maintain good records. We sometimes expect them to a little more than necessary because when a client comes to you, they've got to Schedule C business. Maybe you prepare the tax return while they're sitting in front of you, right? The old fashioned and oops, there's an expense that they can't.

They have this particular expense, but they can't remember what it is. For expediency, they may just estimate it instead of sending the client home and saying, go be very perfect. I have to know what you've got down to the penny. Because don't forget, there is a cost benefit analysis. If the client says, you know, I spent \$500 a month, can we just deduct \$6,000? What's the odds that client is going to be materially wrong?

I would say most of the time, as long as you've got an honest client, because we know that there's the dishonest ones out there, as long as you've got an honest client, if they go back and they do their research, do you really want to force them to go to, you know, four hours of digging through old receipts and whatever they've got to discover that it wasn't \$500. It was \$480 or \$520. So I think that those estimates are okay as long as there is real basis for them. We'll talk a little about estimates again. We get to a little bit of ethics discussion in a short little while.

But we did, there was a book on this topic and it was a little bit of background on Mr. George Cohen, which I think was interesting. Because from 1904 to 1919, George Cohen was the most successful figure in American theater. And in 1911, he and his partner Sam Harris had six hit shows on Broadway and controlled seven theaters. If you can imagine this person going into an audit and an auditor saying you have no business expenses. Well, that clearly is not the case. This person has some real legitimate business expenses.

Now, if we fast forward a little bit to more modern internal revenue code, we've had a couple revisions to the internal revenue code since 1921 and 1922. We do deal with section 274(d), which does mandate supporting documents in some cases where estimates are not allowed. So when I talked about allowing estimates, that's not in all cases. Section 274(d) does require there to be real substantiation and no estimates are allowed in certain cases. First under sections 162 and section 212, section 162 is your ordinary necessary business expenses. Section 212 are your ordinary and necessary expenses in an activity and you know, entered into for profit, but not necessarily a trade or business.

So, they're almost identical in terms of what they, the purpose of these two sections. But here in under sections 162 and section 212, any traveling expenses, including meals and lodging away from home require actual documentation. Any expenses for gifts, those are business gifts obviously, or with respect to any listed property under section 280 cap F. You've got to have substantiation.

Because unless the taxpayer can substantiate by adequate records or by sufficient evidence corroborating their own statement, they need to have the amount of the expense or other item, the time and place of the travel or the date and description of the gifts, if we're talking about a gift, the business purpose of the expense or other item, and the business relationship to the taxpayer of the person receiving the benefit. You've got to have all those things.

So when it comes to things like travel, business meals, your client should be taking that receipt and marking on there. "Lunch with John Doe, discussed such and such deal, blah, blah, blah." It doesn't have to be terribly detailed, but some level of detail to provide the necessary information. Don't forget entertainment expenses are not allowed under the Tax Cuts and Jobs Act, the old TCG.

I should call it the old TCGA now because it's over eight years old now. OBBA did not, OBBA being the One Big Beautiful Bill Act did not have any effect on this because, if you remember, the elimination of entertainment expenses as a deductible business expense was a permanent provision of the TCGA. OBBA didn't make any changes. It didn't have to make any changes. So entertainment expenses remain deductible at a rate of 0%.

So when it comes to using Cohen and preparing tax returns, right? First, I am a fan of preparing tax returns properly. I'm sure you are too. In an ideal world, our client is going to give us everything. Well, not everything. I don't want to see receipts from my clients, but they will have added up all their receipts and given me, if they're a schedule C, they will give me a nice P&L. If they've got rental properties, hopefully I've got a nice P&L for the rental.

And I will have a nice itemization of their well itemized deductions, right? Hopefully with supported documents like 1098d from mortgage interest, substantiation from charities, listing all of the acknowledgement letters and all those good things. But don't forget, you're not required to audit your client's records. So when my client comes to me and fills out their organizer, and let's say they tell me on their schedule C business expenses that they had, do one expense is just extraordinarily high. I have to ask them about it. I can probe them a little bit. Hey Joe, why are your travel expenses so high this year? And if Joe says, yeah, you know what? I, I attended, five or six more trade shows than I normally would than I do normally in a year. So I had extra travel expenses because they attended more trade shows.

That's enough of an answer. great, right? I've satisfied myself that this wasn't an error and they had legitimate travel expenses. I'm going to deduct it. But I don't have to actually audit my client's records. If the taxpayers can provide sufficient proof, they incur a trade or business expense, but they're unable to substantiate it, they can reasonably estimate the amount and the deduction is allowed.

But again, if they are audited, the IRS can make every assumption against your client. Right? If your client says, spent \$10,000 on X amount of expenses, the IRS could say, you know what, for a business your size and your industry, nobody's spending more than \$5,000. We'll let you have \$5,000. They can do that. And without substantiation, the burden is really on you to disprove that, which can become very difficult.

Now Cohen can be applied in other areas. Cohen did specifically deal with business income and expenses. More specifically was mostly meals and entertainment type expenses of actors and other producers, directors and all that. But it can be applied in other areas. Gambling losses. How many of your clients who have gambling winnings have a very good record of their gambling losses? Not many. Most of them will say, yeah, I've got this W-2G for \$10,000, but I spent way more than that at the casino.

I don't think many of us would really question our clients there because that's, know, the house always wins. Very rare to come out ahead. So for most clients, they do have gambling losses and excessive winnings. And if they don't have, you know, perfect records to substantiate that, I'm no, I'm not going to push my clients. Some credits, same thing. Determining an asset's basis, right? How many people know the basis of their home, for example?

I can't tell you how many clients I've got who've sold their home. And you ask them, okay, what's the basis? And they remember maybe they bought it for, they sold their house for a million and a half dollars today. They bought it for \$40,000, 45 years ago, maybe 50 years ago. They've done some improvements, but they didn't keep records.

I had a client who insisted he kept great records. He had a record of everything he did, all the improvements he made to his house over like a 45-year period. Went up to his attic, took out his box that he had all his old receipts in and they had all faded to blank paper. So he thought he was keeping good records, but he had nothing that we could read.

And I laughed at that because he was certain he knew the basis or could calculate the basis of his home and he couldn't. So when comes to home sales, I got to admit, I've got a lot of clients. I have to send them home and say, go and just spend a couple of weeks trying to remember all the improvements you did, write them down, write down how much you think you paid for them. And that's the best we have sometimes. And that happens and that's okay. It's not ideal, but it's okay.

So what does the Supreme Court state on this topic? Well, in one case, the Colonial ICE case, they said, whether and to what extent deductions shall be allowed depends on legislative grace. Because that's very important topic, a very important concept, I should say, in the income tax world. Tax deductions are a matter of legislative grace. And what that means is if Congress says you can't deduct something, guess what?

It's non-deductible. They say entertainment is not deductible. It's not deductible. They say interest on your credit cards is not deductible. It's not deductible. There are some personal expenses we get to deduct. Mortgage interest, soon to be some car loan interest thanks to the One Big Beautiful Bill Act. Charitable contributions. These are not business related, but they were allowed to deduct them because Congress wants to direct the way we spend our dollars or incentivize certain spending, I should say.

But other things are simply not deductible. Entertainment is no longer deductible. One half of your business meals are not deductible and so on and so forth. So you have to have some substantiation in the code in order to deduct something. You can't just deduct something because you spent money on it. I think we've all had that client who somehow thinks that every outflow from their checking account is a magically attached deduction somehow. Not the case. Got to have some substantiation within the code.

There's a couple of citations there for the footnotes I had in the last slide.

But one taxpayer didn't even try. This is the Williams case. This is kind of still within our umbrella of talking about Cohen. In this case, we had a taxpayer that was given an expense allowance of \$500 a month from his employer for which he wouldn't have to account. So what they call a non-accountable plan, which means a taxable income to him. But then he gets to deduct any business expenses he has. Well, at least he could have, you know, prior to 2% miscellaneous itemized deductions going away and all that.

This case is from 1957, so you get the point. So here the taxpayer made no effort, none, zero, zilch how much he spent in any way to identify any of his expenses. He simply said, my employer gives me a \$500 spending allowance every month. I spend that and more on business expenses. The end. Didn't try to itemize it, didn't have any receipts, had nothing. Just tried saying, I spend at least that.

And here, you know, what happened was, you know, for the basic requirement, there must be sufficient evidence to satisfy the court or the IRS in an audit that at least the amount allowed in the estimate was in fact spent or incurred for the reason the taxpayer said. Here, Mr. Williams just provided nothing. He was so arrogant. He simply said, I spend that, deal with it. Give me the deduction and get out of my face.

He was, in fact, allowed nothing because he made no attempt at giving any kind of accurate estimate or anything. So here, even though he tried to provide or tried to use the Cohen rule, you know, you still have to have some level of substantiation even if it's only credible testimony on your own part You've got to have something.

So how do we establish expenses in the absence of verification if you have none? Oral testimony, prior year tax returns, industry norms could all be used. Other industry statistics have been offered to assist courts in arriving at estimates in the absence of adequate identification. It has happened. But the taxpayer has got to be honest and truthful. And that's a big deal. You get into an audit with a client. If you allow your client to go to the audit and meet with the auditor, or if you're giving testimony to the tax court, people can tell when your client is being honest and when they're not.

Don't forget the reason why you don't have records is a big deal as well. Do you just not keep any records? That's going to weigh heavily against your client. Or did your client lose everything in a fire and did their best to estimate what they had? The court is going to give that fire victim a lot more leeway than the person who just doesn't care to keep anything.

So estimates, when we talk about the ethical use of estimates for us, estimates can be used, but they have to be used ethically. And so a member, meaning this is from the AICPA, may advise on estimates used in the preparation of a tax return, but the taxpayer, this is the important part, has the responsibility to provide the estimated data. You can't make the estimates for you. Your client's got to be the one who says, here's how much I think I spent. It is up to them to provide the estimates, not you.

And a member may use the taxpayer's estimates in the preparation of a tax return if it's not practical to obtain exact data. And if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. Go back to my example where I said you're preparing a tax return in front of a client and there's one particular expense that they can't remember. And they've estimated it at \$500. What does it mean to use estimates if it's not practical to obtain the data? I would say it's not practical to make my clients spend one hour searching for something if we think we're going to be off by 20 bucks plus or minus, big deal, right? The larger the dollar amount, the more onus there should be on the taxpayer to try to find a real dollar amount. But small items, there's a cost benefit analysis.

I know that, know, as accountants, we want to be, we want everything to tick and tie and be perfectly accurate with everything. But don't forget, we are also in a business and, cost benefit analysis, both for us and our client must play a part.

Anyway, I want to move on beyond Cohen. There's a little more on the couple of slides here with the citations and things, but I really want to move on past, this part of COA and at get to circular 230 discussion here when we talk about some of the regs.

As a practitioner, we've got to exercise due diligence in preparing or assisting in the preparation of a tax return, determining the correctness of oral or written representations made by us, and determining the correctness of oral or written representations when administering the Internal Revenue Code. So again, you've got to have due diligence. If the client gives you estimates, you should at least make sure that there is some kind of real substantiation there, some kind of real basis. Don't let somebody just make numbers up.

Because they want to make numbers up, you know, I don't know if you've ever had the experience, I've had the experience where I've got maybe a new client, somebody who's referred to me and they were talking about deductions and they start asking for my opinion on what's reasonable to not get audited. That is a huge red flag. I send them packing right away. Somebody who's asking my opinion on how profitable they should make their Schedule C on the books to avoid an audit. No.

What were your income? What was your business income? What were your expenses? That's what dictates your profitability. That's what dictates your tax liability. Not me trying to help you prepare a fraudulent tax return. So make sure if you get those, if you do get those clients, if you ever had that experience, send them packing. That is a very rare occurrence for me, but it has happened in my career.

Anyway, I want to go on to the next case. I want to talk about Harary. So, with Harary here, a practitioner is presumed to have exercised due diligence for purposes of Circulator 230 if the practitioner relies on the work product of another person and the practitioner uses reasonable care in engaging, supervising, training and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person. And that's where we sort of get into Harary, where I think a lot of us noticed, or at least kind of took extra notice, I should say, of this type of provision, where we can rely on the work product of somebody else whose exercised due diligence, think about the employee retention credits under COVID where some other company did an employee retention credit work and simply told us, here's how much of a credit, that our client is getting.

Or maybe if your client engages in credit studies, maybe it's a research credit study or somebody else does a, a cost segregation study. Our client has hired a professional outside firm who has expertise in this particular item. We, as a tax professional preparing the income tax return, we can rely on that and we've done our due diligence, right? We're looking at the report. We can make a lot of assumptions that this company knows what they're doing. Now, you can't rely on them blindly. I will tell you I've had clients in the past that have claimed research credits because some salesperson has told them they qualify for a research credit. And I look at the nature of my client's business and I say, no way, no how. You are conducting no research. I know you, you are not.

I'll tell you a quick anecdote from my practice. I had a client who operated a nursing home and he was sold that a, from a research credit study company, that he could claim a research credit for operating a nursing home. There's no research being done in this nursing home. None, zero, zip, zilch. I did not claim that. I ultimately ended up sending him somewhere else saying, look, if you want to claim that fine, but I'm not the one doing it for you. But apparently my 20 plus years of tax acumen was no match for a two-year out-of-college salesperson telling my client he could get an awful big credit.

So I wasn't disappointed when I lose clients like that because they are going to be, in the long run, in more trouble than they're worth.

So, here Mr. Harary was disbarred and he was disbarred after a criminal proceeding where he was charged with bribing and conspiring to bribe a special agent of the IRS and with paying the agent a gratuity. You cannot tip the IRS, right? You can't shake their hand with a \$100 bill like you're mafioso. And here, I love this one. He admitted that he paid the agent \$1,250 on behalf of his clients, thought he was bribing them, but he told his client that the IRS agent actually wanted \$2,000 and he kept the \$750 in his own pocket. So what happened here, this just gets better. So he was tried before a jury. He was actually acquitted, believe it or not, on the conspiracy and the bribery charges. Was ultimately convicted of paying just a gratuity to the IRS agent, which you can't do. But why was he actually disbarred? He was disbarred from practice before the IRS for being dishonest with his client. Not for the bribery part, because he was acquitted on that, but because he told his client the IRS agent wanted a \$2,000 bribe, but it was only \$1,250. And he told his client, \$2,000, he kept \$750, paid the \$1,250 bribe. But it was ultimately the dishonesty with his client, not the act of bribing the IRS agent that got him disbarred from practice before the IRS. So you got to love that.

So, what are the regulations here, Circular 230 mean? Well, they really mean quite simply that you've got to be honest with your client in connection with all IRS related matters. A deliberate conveying of misinformation is more, is worse conduct than careless misrepresentation. So you've got to be honest with your client, cannot lie to them when you're representing them before the IRS.

So the Harary case, the moral of the story here is behave properly, be professional, don't bribe the IRS, don't lie, don't cheat, don't steal. That was a very short one in our discussion here. But I actually just the facts of that one are too good to pass out had to but let's talk about Churchman.

Churchman is I think a much more important case when it comes to tax preparation for us. And this is a hobby loss case at its core. And you know, when it comes to hobby losses, the IRS likes auditing Schedule C businesses, especially Schedule C businesses that produce losses because that's ripe ground for the IRS to come in and sweep in with the hobby loss rules. Because now, with the TCGA first, you know, suspending 2% miscellaneous itemized deductions, and now with the One Big Beautiful Bill Act permanently eliminating them, a hobby loss determination is extra bad for your client because all of the revenue generated from their hobby or from their activity, I should say, is fully taxable, but they don't get to deduct any of their expenses.

One exception, cost of goods sold is always deductible. Even drug traffickers get to deduct cost of goods sold. But the rest of your expenses are non-deductible. So you can have an activity that you're not engaging for profit. It's really a hobby, but you have collected some money within it. That's all taxable and you don't get to deduct any of your offsetting expenses. It's really, really a bad thing. And so the question here is the taxpayer in a trade or business? Do they have a bona fide profit motive? And it's not a question of did they make money? If they have a loss, clearly they did not make a profit and their expenses exceeded their income. What is their profit motive?

Now for purposes of section 183, which are the hobby loss rules and its regulations, an activity is not engaged in for profit because the term hobby is not actually used in the code. It's quote an activity engaged in for profit means an activity other than one with respect to which deductions are allowable for the taxable year under section 162. No deductions are allowed for expenses incurred in connection with activities that are not engaged in for-profit at all. And the determination of whether an activity is engaged in for-profit is to be made with reference to objective standards, taking into account all the facts and circumstances of each case. And so in determining whether such an objective exists, it may be sufficient that there's a small chance of making a large profit. We're going to sort of bring all this home and see what this means as we discuss this case here.

So what are some relevant factors to think about? And we'll get to the presumption in a few minutes. But in determining whether activity is engaged in for profit, all facts and circumstances are relevant with respect to the activity and must be taken into account and no one factor is determinative. So what are the factors? There's generally considered nine factors that courts are going to look at and the IRS is going to look at when determining whether an activity has been entered into for profit. And I've got those in the following slides here.

First and foremost, number one, the manner in which a taxpayer carries on the activity. Are they carrying on their activity in a business-like manner? Are they keeping good books and records is a big part of that. How are they carrying on the activity? Second factor is the expertise of the taxpayer and their advisors. Is your client an expert in this particular field that they're in? Do they have something they're doing? And this is going to be really getting to the, to the core of Churchman. So hold on to the sort of this one for a second, the expertise of the taxpayer or their advisors in this area.

The time and effort expended by the taxpayer in carrying on the activity. So, the fact that a taxpayer devotes much of their personal time and effort in carrying on an activity, particularly if the activity does not have substantial personal or recreational aspects, can't indicate an intention to derive a profit. Would you and I spend all of our time on something that's not profitable? Probably not. But if we only spend say 10% of our time on an activity and went to loss, that may look like it's more of a hobby.

Is there an expectation that the assets used in the business may appreciate in value? That's a big deal. I'll give you an anecdote from my own practice on this one. I had a client whose wife owned an antique mall. So, she owned the building and she had the typical antique mall where she charges rent to all the people who have small antique businesses. And she died and he kept the mall going.

It was early COVID, the real estate had taken a dive, but he had no intention of running the antique mall to be profitable. It was in fact losing money. But what he was doing was he was holding onto that real estate, waiting for it to increase in value because it was in a good area. And as soon as the market sort of turned around, he ended up selling the real estate for a very large profit, an asset used in the business. So, he kept the antique mall going just to help kind of cover some of the expenses of operating, property taxes, utilities, everything is going to help keep the property up, you know, up and moving. And was ultimately able to sell this asset from the business for a very large profit. He wasn't audited, but if he was, this was one factor I was prepared to, you know, hit on very hard. The success of the taxpayer and carrying on similar or dissimilar activities.

Number five here. If you've got a client who's successful at taking a particular type of business that's operating at a loss and turning it around and making a profit, then the next time that client does that and they're doing it with the next activity, that looks like a profitable activity that they're entering into with the intention of making a profit. Right, just because they've got losses for a few years doesn't make it automatically a hobby.

Number six, a taxpayer's history of income or losses with respect to the activity. What if you've got a client who's always been very profitable, but they fall on a few hard years because of circumstances outside of their control? In that case, they've got a history of income. They were profitable. Why are they not profitable? Today may indicate that it's still a business. It's just not a profitable one right now. The amount of occasional profits, if any, which are earned. This is what we get to our three out of five year rule. There's a presumption that if you turn a profit out of three every five years, your activity is engaged in for profit.

I have seen people, because they've talked to me about people have talked to me about tax activities all the time, where people have told me, yeah, try to, I make my little schedule C just a little bit of profitable every three, you know, three out of five years, but the two years that I have losses, I have really, really big losses and I deduct them. They're trying to create, they're trying to manipulate their schedule C to have very small losses to get around the hobby loss rules.

And then they have these really big losses in their other years. That doesn't mean that you're going to be treated as a business. It just means there's a presumption. If you turn a profit in three out of five years, it's a presumption, simply the burden is on the IRS to prove that you are not a business. It doesn't mean you're definitively defined as a business.

The eighth factor, the financial status of the taxpayer. If you've got a taxpayer who's very independently wealthy, then for them to just keep funding losses into a business that they really don't intend to make a profit, they have the ability to do that. Therefore, it looks like they might have a hobby versus somebody who's got more meager means and they're pouring their heart and soul and everything they have into this activity. It looks more like a business because they're trying to make a profit. They're busting their hump to try to make this thing work.

The last one is elements of personal pleasure or recreation. I've had clients that want to start a golf apparel business and they want to take what is a hobby, something they love doing. And they do want to turn it into a business for themselves. And they try to find some way of doing that. And if they have losses in the first few years, for example, you want to get into the golf industry, which a lot of people want to get in the golf industry.

The fact that you want to do that, does that mean that you, know, it's a point of pleasure for you, point of recreation for you, that you can't turn that into a business? So, I really don't like this, this one, but it is one of the factors.

So, let's get to the fact of Churchman and I'll try to finish this one up in just a couple of minutes. Churchman was a married, they were a married couple, but really we're looking at the activities of the wife in this case. The wife was a professor at University of California in Berkeley.

And she was an art professor and she was an artist and so this case dealt with her artist activities, know that she created art tried selling it and she went 20 years and never turned a profit. A loss every single year and so why do we care about this case? Well to kind of cut to the chase we care about this case because she won.

She never turned a profit in her activity, but she still won on an audit and proved that her activity was a trade or business and was not an activity engaged in for a non-profitable purpose. It was not a hobby. And so here, what she did was she had two and a half years of graduate experience in art school. She taught art, she created art. She maintained a mailing list of names of students, friends, customers, art galleries. She would go to art galleries, try to sell her work, try to get her work shown. She started making posters and cover art for books to try to make her art more available to the public and more profitable. She started creating her own book, her own art book, showcasing the art that she'd done, almost like a coffee table book, to try to make her art more accessible.

And even though she never turned a profit, how did she win? She won because her expectation of a profit does not have to be reasonable, according to the tax court. She must establish that she continued her activity with a bona fide intention and an expectation of making a profit. Now, the nature of her business plays a very large role here as well because the nature of her activity was that of a struggling artist. And the court recognized that. They said, look, artists can go many, many, many years of being unprofitable. And then suddenly, a bolt of lightning, they become very profitable, very popular. And so for an artist, that's something that may have to happen in their business before they suddenly become recognized.

You can't be an artist and just you know automatically assume that you're going to become the next Picasso because you've been painting for two years, right? It can take a very very long time. So the nature of the business the nature of the industry can dictate whether you are profitable or not.

So, this quote I've got here with that with the bold here with the struggling artist is a big deal for this case, but you can have clients who have a very similar scenario, very similar type of situation. Because while her artwork involved recreation and personal pleasure, right, remember that requirement that I don't like, her work didn't stop at the creative stage. She worked on the marketing phase, right, going to the galleries and doing all these things, making, sending out, you know, phone calls to her phone list, when she's got new art, when she's got new gallery shows and things.

She had an education. She was an expert in art not only by education, but she also taught art. She was a dedicated artist. So she knew what she was doing even though she was not yet profitable. And here she won. And so here I think that, when you've got a client who's got a hobby determination, you know, maybe looming from the IRS, you really want to harp on those nine factors.

And really try to find something within your client's facts that indicates why they are a business and not a hobby. Why the IRS's presumption doesn't or shouldn't apply to them.

Agarwal is a real estate professional case. Here you had a taxpayer who was a real estate agent in California, tried to treat herself as a real estate professional, and the IRS had audited her and said, you're a real estate agent, you're not a broker. The code and regulations only says that brokers can be treated as real estate professionals. There's others in there, but point being not agents. And here what the court did was the court had looked at the definition of what is a broker, what does she do as a licensed real estate agent in California, and what she did meets the dictionary definition of what a broker is, even though she's not called a broker.

And even though the IRS tried defining there's a difference between a broker and an agent in California, here the court said, you know what, that doesn't matter to us, even though this is a tax court summary opinion. This is a big deal here because this was one of the first cases, maybe even the first case that drew this distinction here between an agent and a broker. And here the court said, look, according to the federal income tax definition of a broker, a real estate agent meets that definition. Therefore, we don't care what California's definition may be of a broker versus an agent.

A real estate agent can be a real estate professional. Now, how do we get to being a real estate professional? Let's talk about a couple of the requirements here.

Being a real estate professional requires a two-step test. More than one half of the professional services performed in trades or businesses by a taxpayer during the year have to be performed in real property trades or businesses in which the taxpayer materially participates. And the taxpayer has to perform more than 700 hours of service during the year in real property trades or businesses in which they materially participate.

If you meet that two-factor test, you are a real estate professional. Why do we care about being defined as a real estate professional? If you are somebody who's a real estate professional and you own your own rental activities, your own rental real estate, then you can potentially deduct your rental real estate losses as ordinary income against your other income. Now here's where the disconnect happens in the courts whenever there's a real estate case in front of the courts. You almost always have somebody who is a real estate professional, whether they're a real estate agent, broker, maybe they're a property manager, somebody who meets the definition of a real estate agent. And they think that because they're defined as a real estate agent, I'm sorry, a real estate professional therefore, all of the losses from their rental activities are automatically treated as non-passive and they get to deduct all their real estate losses against their other income, their ordinary income. And that's not the case because the real estate professional test is a two-pronged test, which we just went through. But in addition to that, you have to materially participate in each and every one of your other activities in order to treat them as non-passive.

So that means you have to materially participate in each and every single one of your rental properties or you can file a single activity election treat all of your rental activities as a single activity and then you have to meet the material participation tests with regard to that entire activity and grouping of properties not each property individually.

Because Mrs. Agarwal owned an interest in rental property, performed more than one half of her services, and she materially participated and performed more than 750 hours of services in real property trades or businesses in which she materially participates. She's a qualifying taxpayer as far as a real estate profession is concerned. And then she had to meet the seven, one of the seven material participation tests with regard to each and every single one of the rental activities, again, unless she, unless she made a single activity election.



Webinar

Tax Cases That Will Save Your Clients Money, Give You Courage, and Protect Your Tax Practice

Presented by [Mike Giangrande, J.D., LL.M.](#)

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Mike Giangrande, J.D., LL.M.

Mike Giangrande is a California licensed attorney and has been a tax practitioner for 25 years. He is licensed to practice before the United States Tax Court, has a B.S. in Accounting and an LL.M. (Tax) from Chapman University, and has a J.D. from Whittier Law School. Mike has spent time as an adjunct professor of [law](#) and he served as a member of the Orange County Assessment Appeals Board.

Mike has served as the Federal Tax Editor for Spidell Publishing, LLC since 2017 and has been lecturing during that time. Mike authors many tax manuals and webinars each year.



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Learning Objectives

Upon completion of this webinar, participants should be able to—

- Apply the **Cohan** rule in tax preparation and audits
- Identify the factors in **Churchman** that the court focused on to provide the taxpayer a clean victory
- Examine the history in **Agarwal** from §469 to §199A
- Determine how vital a role a TC Summary case can play
- Assess what transpired in a litigated case about tax ethics in **Harary v. Blumenthal**

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Cohan v. Commissioner of Internal Revenue, Cite as 8 AFTR 10552, (CA2), 03/03/1930

- Cohan was a 1930 decision of the U.S. Court of Appeals for the Second Circuit (New York)
- The case was an appeal by the taxpayer, George Cohan of a decision of the Board of Tax Appeals (the Board), which was the predecessor to the United States Tax Court.
- The case involved the disallowance of business expenses of the taxpayer, George Cohan in 1921 and 1922
 - Cohan was technically a fiscal year taxpayer for the years at issue, but the facts of the case have been simplified here.

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Cohan's Background and Business Records

- George Cohan was a theatrical manager who wrote and produced plays.
- He got his start as a child actor performing in vaudeville with his parents and sister.
- As a theatrical manager, he was “free-handed” with his business expenses in entertaining actors, employees and even theater critics. He also incurred a lot of travel expenses as part of his business.
- Mr. Cohan did not keep business records and, as the U.S. Court of Appeals noted, probably could not have kept accurate records.
- Cohan estimated that his expenses were \$33,000 in 1921 and \$22,000 in 1922, totaling \$55,000 in all.

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The Issue to be Decided

- Because Cohan did not maintain business records, the Board of Tax Appeals disallowed all of his deductions.
- **Issue** for the Appeals court decide: How far is the Board's refusal to allow Cohan any business expenses justified, in view of the Board's finding that he had, in fact, incurred significant expenses in his business?

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Key Language from the Case

- “Absolute certainty... is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making.”
- “...to allow nothing at all appears to us inconsistent with saying that something was spent”
 - Remember, the Board acknowledged that Cohan incurred significant expenses (even if they didn’t come to a decision regarding the amount of his expenses)

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Key Language from the Case

- “True, we do not know how many trips Cohan made, nor how large his entertainments were; yet there was obviously some basis for computation, if necessary, by drawing upon the Board’s personal estimates of the minimum of such expenses.”
- “The amount may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong [of the Board] to refuse any, even though it were the traveling expenses of a single trip.”
- “It is not fatal that the result will inevitably be speculative; many important decisions must be such.”
- “We think that the Board was in error [to disallow all of Cohan’s expenses] and must reconsider the evidence.”

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Reading Lyrics by Robert Gotlieb and Robert Kimball

- From this wonderful book: For fifteen years—from 1904 to 1919—George M. Cohan was the most successful figure in the American theater. In 1911, he and his partner, Sam Harris, had six hit shows on Broadway and controlled seven theaters.
- Notice that Mr. Cohan spent \$55,000 on entertainment expenses in the years at issue. He did not have documentation. The Second Circuit decided that, even in the absence of evidence, he should be allowed an amount, even though “the amount may be trivial and unsatisfactory.”

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Code Section 274(d)

- Section 274(d) mandates supporting documentation. Estimates are not allowed.
- **274(d) Substantiation required.**
- No deduction or credit shall be allowed—
- **(1)** under **section 162** or **212** for any traveling expense (including meals and lodging while away from home),
- **(2)** for any expense for gifts, or
- **(3)** with respect to any listed property (as defined in **section 280F(d)(4)**),
- unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item, (B) the time and place of the travel or the date and description of the gift, (C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of the person receiving the benefit. The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations. **This subsection** shall not apply to any qualified nonpersonal use vehicle (as defined in **subsection (i)**).

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Other Changes to 274

- Further, entertainment expenses are not allowable under the TCJA
- Kudos: As a tax attorney, I have experience with the **Cohan** [case](#), and arguing for its use on behalf of clients. I want to speak about using **Cohan** not only in audit [representation](#), but understanding that this also ties in with the AICPA SSTS 2.4 Use of Estimates, using estimates in preparing a return.
- More thanks. There is a wonderful paper by Bruce W. McClain and Richard Molina, Understanding the Cohan Rule and How to Use It, published in Tax Notes, July 23, 2018. I will draw on that paper, my experience, and RIA Checkpoint materials to provide some details.

Best to Have Full Documentation

- I am a big fan of preparing tax returns properly. Returns should be prepared with a full understanding of the tax law. Clients should provide all [information](#) and organizers should be used.
 - Remember, however, that you are not obligated to audit your clients' records.

Summary of the Finding

- If the taxpayer can provide sufficient proof that she has incurred a trade or business expense, but is unable to adequately substantiate the amount thereof, the taxpayer may reasonably estimate the amount, and a deduction will be allowed to that extent.
- Note that the **Cohan** rule can be applied in other areas, such as gambling losses (see, e.g., *Doffin v. Commissioner*, T.C. Memo. 1991-114), some tax credits (see, e.g., *McFerrin v. United States*, 570 F.3d 672 (2009)) and determining an asset's basis. This webinar focuses on trade or business deductions.

Colonial Ice

- **¶K-1001. No deduction unless the Code provides for it.**
- The Supreme Court has stated: “Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.”¹ Thus, in order to establish his right to a deduction, a taxpayer must be able to point to some provision in the law and show that he comes within its terms.²
- **RIA observation:** However, it would be impossible for the Code to anticipate and specify every item which is deductible within the intent of the Code provisions. Consequently, IRS's regs and rulings as well as the decisions handed down by the courts must be searched to find authority for a particular deduction.

Put Ice on it

- ¹***New Colonial Ice Co. Inc. v. Guy T. Helvering***, (1934, S Ct) **13 AFTR 1180**, 292 US 435, 78 L Ed 1348, 4 USTC ¶1292.
- ²**Code Sec. 63(a); *New Colonial Ice Co. Inc. v. Guy T. Helvering***, (1934, S Ct) **13 AFTR 1180**, 292 US 435, 78 L Ed 1348, 4 USTC ¶1292; Laque, Harold W., (1970) **54 TC 133**; Laque, Prudencia P., (1970) **TC Memo 1970-28**, PH TCM ¶70028, 29 CCH TCM 88; Parsons, Charles Edward, (1970) **TC Memo 1970-29**, PH TCM ¶70029, 29 CCH TCM 88.

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Taxpayers Who Don't Even Try

- ***WILLIAMS v. UNITED STATES***, Cite as 51 AFTR 594 (245 F.2d 559), (CA5), 06/18/1957
 - In this case, the taxpayer was given an expense allowance of \$500 per month for which he would not have to account. And he did not.
 - But the Taxpayer made no effort to establish how much he spent or in any way identify any of it with respect to any particular entertainment, either of event, persons, or amounts. All he could say was that he was certain that he spent all or more than all of it in paying for food, liquor and travel in the entertainment of customers.

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Make an Attempt, Please

- That the trier, whether District Court or Tax Court, might have considerable latitude² in making estimates of amounts probably spent in the light of accepted practice amongst law-abiding businessmen of moral standing considering the nature and kind of records which might reasonably be kept for such expenditures, **Cohan v. Commissioner**, 2 Cir., 39 F.2d 540, 543, certainly does not require that such latitude be employed.
- The District Court may not be compelled to guess, or estimate. It may not be compelled to estimate even though such an estimate, if made, might have been affirmed. For the basic requirement is that there be sufficient evidence to satisfy the trier that *at least* the amount allowed in the estimate was in fact spent or incurred for the stated purpose. Until the trier has that assurance from the record, relief to the taxpayer would be unguided largesse.

Like the Punch Line Says, “Buy a Ticket.”

- Here the evidence did not offer that assurance to the District Court. His negative finding of insufficient evidence to afford a guide for the allowance of all claimed or, if not that, as a lesser amount a fair estimate, was not clearly erroneous, Fed.Rules Civ.Proc. rule 52(a), 28 U.S.C.A. Certainly we could not compel the Court to allow the full \$6,000 and between that figure and zero, the Taxpayer offered not a single guide, by illustration or otherwise upon which to exercise the asserted capacity to resolve by estimation. The Taxpayer failed reasonably to establish, Section 22(n) (3), 26 U.S.C.A. 1952 Ed. § 22(n) (3), the "expenses paid or incurred by the taxpayer, in connection with the performance by him of services as an employee, under a reimbursement or other expense allowance arrangement with his employer.

So, How Do You Establish Expenses in the Absence of Verification

- Among the numerous methods used by taxpayers, oral testimony, prior years' tax returns, industry norms (such as the North American Industry Classification System (NAICS) directory), and other industry statistics have all been offered to assist courts in arriving at estimates in the absence of adequate documentation.
- **Credibility is the key** in these issues. Reconstruction can be approached from various avenues, but the taxpayer must be honest and truthful. Sure, it would have been better had the taxpayer kept meticulous books and records, but, if the taxpayer does their best, they will likely come out relatively fine.

SSTS Number 4

- Estimates can be used, ethically.
- The AICPA SSTS states:
- **2.4—Statement on Standards for Tax Services No. 4, Use of Estimates**
- **Introduction**
- 1. This Statement sets forth the applicable standards for members when using the taxpayer's estimates in the preparation of a tax return. A member may advise on estimates used in the preparation of a tax return, but **the taxpayer has the responsibility to provide the estimated data.** Appraisals or valuations are not considered estimates for purposes of this Statement.

Number 4

Presentation last modified: November 7

- **Statement:** 2.4.2 Unless prohibited by statute or by rule, a member may use the taxpayer's estimates in the preparation of a tax return if it is not practical to obtain exact data and if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. If the taxpayer's estimates are used, they should be presented in a manner that does not imply greater accuracy than exists.
- **Explanation:** 2.4.3 Accounting requires the exercise of professional judgment and, in many instances, the use of approximations based on judgment. The application of such accounting judgments, as long as not in conflict with methods set forth by a taxing authority, is acceptable. These judgments are not estimates within the purview of this Statement. For example, a federal income tax regulation provides that if all other conditions for accrual are met, the exact amount of income or expense need not be known or ascertained at year end if the amount can be determined with reasonable accuracy.

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More 4

- 2.4.4 When the taxpayer's records do not accurately reflect information related to small expenditures, accuracy in recording some data may be difficult to achieve. Therefore, the use of estimates by a taxpayer in determining the amount to be deducted for such items may be appropriate.
- 2.4.5 When records are missing or precise information about a transaction is not available at the time the return must be filed, a member may prepare a tax return using a taxpayer's estimates of the missing data.
- 2.4.6 Estimated amounts should not be presented in a manner that provides a misleading impression about the degree of factual accuracy.

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- 2.4.7 Specific disclosure that an estimate is used for an item in the return is not generally required; however, such disclosure should be made in unusual circumstances where nondisclosure might mislead the taxing authority regarding the degree of accuracy of the return as a whole. Some examples of unusual circumstances include the following:
 - a. A taxpayer has died or is ill at the time the return must be filed.
 - b. A taxpayer has not received a Schedule K-1 for a pass-through entity at the time the tax return is to be filed.
 - c. There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
 - d. Fire or computer failure has destroyed the relevant records.

Another Reference

- Another great paper is: A Fair Approach to Tax Compliance During TCJA Implementation by Michael D. Levin, Tax Notes Federal, April 20, 2020, page 405.
- Again, it is best for the clients to be excellent bookkeepers, keep completely detailed books and records, and never make a mistake on QuickBooks.
- Having said that, my clients are human beings, and I have used the **Cohan** rule throughout my entire career. To good use.

Ethics

31 USC 330 states the following:

- **§330. Practice before the Department**
- (a) Subject to section 500 of title 5, the Secretary of the Treasury may—
 - (1) regulate the practice of representatives of persons before the Department of the Treasury; and
 - (2) before admitting a representative to practice, require that the representative demonstrate—
 - (A) good character;
 - (B) good reputation;
 - (C) necessary qualifications to enable the representative to provide to persons valuable service; and
 - (D) competency to advise and assist persons in presenting their cases.

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Regs §10.22 (Circular 230)

- Ethics is behavioral, Title 31 is not Title 26, and Title 26 is the Internal Revenue Code.
- Found in Circular 230, we have 10.22, Due Diligence.
- **Reg § 10.22. [Circular 230] Diligence as to accuracy. (a) In general.** A practitioner must exercise due diligence—
 - (1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;
 - (2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and
 - (3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.

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10.22 More

- **(b) Reliance on others.** Except as modified by §§10.34 and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.
- Best case EVER!!!
- ***HARARY v. BLUMENTHAL*, Cite as 40 AFTR 2d 77-5056 (555 F.2d 1113), (CA2), 05/19/1977**

27

Harary

Take a look at the astonishing facts:

- Appellant's disbarment arose out of a prior criminal proceeding in which he was charged with bribing and conspiring to bribe a special agent of the IRS in violation of 18 U.S.C. §§201(b), 371, and with paying the agent a gratuity in violation of 18 U.S.C. §201(f).
- He admitted that he had paid the agent the sum of \$1,250 on behalf of his client, that he had told the client that the agent wanted \$2,000 and that he (appellant) had kept the \$750 difference.
- Appellant was tried before a jury and was acquitted of the conspiracy and bribery charges, but was convicted of the gratuity charge.

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Harary

- As a separate ground for disbaring appellant, a ground unrelated to his prior criminal trial, the Secretary held that appellant had willfully deceived his client.³
- As stated above, appellant told his client that the IRS agent had to be paid \$2,000, but appellant in fact paid the agent \$1,250, pocketing the \$750 difference for himself.
- The Secretary held that this conduct violated 31 C.F.R. §10.22(c), which requires that each attorney, certified public accountant or enrolled agent "exercise due diligence... [i]n determining the correctness of oral or written representations made by him to clients with reference to any matter administered by the Internal Revenue Service."

The Regs Mean

- The regulation at issue, 31 C.F.R. §10.22(c), requires, quite simply, that a representative be honest with his clients in connection with all IRS-related matters. While the phrasing of the regulation ("due diligence in determining correctness") suggests a principal concern with making representatives accountable for negligence, nothing in the regulation limits it to cases of negligence.
- The term "diligence" carries connotations of loyalty and devotion as well as care and prudence. A deliberate conveying of misinformation is certainly more opprobrious conduct than a careless misrepresentation. Appellant does not dispute the fact that he was deliberately dishonest with his client and, since the dishonesty related to an IRS agent's audit, it was plainly a representation "with reference to [a] matter administered by the [IRS]." Appellant accordingly violated 31 C.F.R. §10.22(c).

Don't You Understand?

- The regulation at issue, 31 C.F.R. §10.22(c), requires, quite simply, that a representative be honest with his clients in connection with all IRS-related matters.
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As if it isn't Clear Enough Yet

- In view of our construction of the regulation, appellant's vagueness argument is rejected. He contends that the words of the regulation did not give notice that a misrepresentation to a client in connection with an audit could lead to disbarment. Apart from the fact that every professional knows or should know that cheating a client can lead to disbarment, the regulation here gave quite specific notice that representations to clients must be correct with regard to a wide but clearly defined range of matters.
- So, be sure to have due diligence. Behave properly. Be a professional. Don't bribe the IRS. Don't lie, cheat, or steal.
- We got a deal?

32

Churchman 68 T.C. 696 (1977)

- The IRS has typically enjoyed auditing Schedule C losses. The issue is not so much the income or the expenses. The issue really circles to IRC Section 183 (Hobby loss rules). And the key to IRC 183 issues are the Regulations, 1.183-2(b).
- Is the taxpayer in the trade or business? Do they have a bona fide profit motivation? It is not a question of did they make money? If they have a loss, clearly they did not make a profit. Their expenses exceed their income.

1.183-2(b)

- **Reg § 1.183-2. Activity not engaged in for profit defined.**
- **(a) In general.** For purposes of section 183 and the regulations thereunder, the term “activity not engaged in for profit” means any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212. Deductions are allowable under section 162 for expenses of carrying on activities which constitute a trade or business of the taxpayer and under section 212 for expenses incurred in connection with activities engaged in for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income. Except as provided in section 183 and §1.183-1, no deductions are allowable for expenses incurred in connection with activities which are not engaged in for profit. Thus, for example, deductions are not allowable under section 162 or 212 for activities which are carried on primarily as a sport, hobby, or for recreation. The determination whether an activity is engaged in for profit is to be made by reference to objective standards, taking into account all of the facts and circumstances of each case. Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into the activity, or continued the activity, with the objective of making a profit. In determining whether such an objective exists, it may be sufficient that there is a small chance of making a large profit. Thus it may be found that an investor in a wildcat oil well who incurs very substantial expenditures is in the venture for profit even though the expectation of a profit might be considered unreasonable. In determining whether an activity is engaged in for profit, greater weight is given to objective facts than to the taxpayer's mere statement of his intent.

Relevant Factors

- **(b) Relevant factors.** In determining whether an activity is engaged in for profit, all facts and circumstances with respect to the activity are to be taken into account. No one factor is determinative in making this determination. In addition, it is not intended that only the factors described in this paragraph are to be taken into account in making the determination, or that a determination is to be made on the basis that the number of factors (whether or not listed in this paragraph) indicating a lack of profit objective exceeds the number of factors indicating a profit objective, or vice versa. Among the factors which should normally be taken into account are the following:
 - *(1) Manner in which the taxpayer carries on the activity.* The fact that the taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books and records may indicate that the activity is engaged in for profit. Similarly, where an activity is carried on in a manner substantially similar to other activities of the same nature which are profitable, a profit motive may be indicated. A change of operating methods, adoption of new techniques or abandonment of unprofitable methods in a manner consistent with an intent to improve profitability may also indicate a profit motive.

9 Factors

- *(2) The expertise of the taxpayer or his advisors.* Preparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are expert therein, may indicate that the taxpayer has a profit motive where the taxpayer carries on the activity in accordance with such practices. Where a taxpayer has such preparation or procures such expert advice, but does not carry on the activity in accordance with such practices, a lack of intent to derive profit may be indicated unless it appears that the taxpayer is attempting to develop new or superior techniques which may result in profits from the activity.
- *(3) The time and effort expended by the taxpayer in carrying on the activity.* The fact that the taxpayer devotes much of his personal time and effort to carrying on an activity, particularly if the activity does not have substantial personal or recreational aspects, may indicate an intention to derive a profit. A taxpayer's withdrawal from another occupation to devote most of his energies to the activity may also be evidence that the activity is engaged in for profit. The fact that the taxpayer devotes a limited amount of time to an activity does not necessarily indicate a lack of profit motive where the taxpayer employs competent and qualified persons to carry on such activity.

Factors

- (4) *Expectation that assets used in activity may appreciate in value.* The term “profit” encompasses appreciation in the value of assets, such as land, used in the activity. Thus, the taxpayer may intend to derive a profit from the operation of the activity, and may also intend that, even if no profit from current operations is derived, an overall profit will result when appreciation in the value of land used in the activity is realized since income from the activity together with the appreciation of land will exceed expenses of operation. See, however, paragraph (d) of §1.183-1 for definition of an activity in this connection.
- (5) *The success of the taxpayer in carrying on other similar or dissimilar activities.* The fact that the taxpayer has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises may indicate that he is engaged in the present activity for profit, even though the activity is presently unprofitable.

More Factors

- (6) *The taxpayer's history of income or losses with respect to the activity.* A series of losses during the initial or start-up stage of an activity may not necessarily be an indication that the activity is not engaged in for profit. However, where losses continue to be sustained beyond the period which customarily is necessary to bring the operation to profitable status such continued losses, if not explainable, as due to customary business risks or reverses, may be indicative that the activity is not being engaged in for profit. If losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damages, other involuntary conversions, or depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit. A series of years in which net income was realized would of course be strong evidence that the activity is engaged in for profit.
- (7) *The amount of occasional profits, if any, which are earned.* The amount of profits in relation to the amount of losses incurred, and in relation to the amount of the taxpayer's investment and the value of the assets used in the activity, may provide useful criteria in determining the taxpayer's intent. An occasional small profit from an activity generating large losses, or from an activity in which the taxpayer has made a large investment, would not generally be determinative that the activity is engaged in for profit.

Almost There

- However, substantial profit, though only occasional, would generally be indicative that an activity is engaged in for profit, where the investment or losses are comparatively small. Moreover an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or only occasional small profits are actually generated.
 - (8) *The financial status of the taxpayer.* The fact that the taxpayer does not have substantial income or capital from sources other than the activity may indicate that an activity is engaged in for profit. Substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved.

Finally

- (9) *Elements of personal pleasure or recreation.* The presence of personal motives in carrying on of an activity may indicate that the activity is not engaged in for profit, especially where there are recreational or personal elements involved. On the other hand, a profit motivation may be indicated where an activity lacks any appeal other than profit. It is not, however, necessary that an activity be engaged in with the exclusive intention of deriving a profit or with the intention of maximizing profits. For example, the availability of other investments which would yield a higher return, or which would be more likely to be profitable, is not evidence that an activity is not engaged in for profit. An activity will not be treated as not engaged in for profit merely because the taxpayer has purposes or motivations other than solely to make a profit. Also, the fact that the taxpayer derives personal pleasure from engaging in the activity is not sufficient to cause the activity to be classified as not engaged in for profit if the activity is in fact engaged in for profit as evidenced by other factors whether or not listed in this paragraph.

Churchman 68 T.C. 696

- California case involving a married couple (the husband was a university professor and the wife was an university professor/sole proprietor artist).
 - The case is a wonderful and powerful case because it digs deep into defining profit motive while recognizing the unique aspects of the taxpayer’s business as an artist.
- A fine paper which cites **Churchman is**: Income Tax Planning for Visual Artists, Their Dealers, Investors, and Collectors by Herbert I. Lazerow. Tax Notes Federal, Volume 170, February 8, 2021.
- We will look at the facts of the case. The facts, of course, drive our conclusion.
- We start with this: During the 20 years that petitioner has pursued her artistic activities, the income from the sale of her artwork had **never** exceeded her expenses in **any** year.

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Facts

- Petitioner C. West Churchman was employed as a professor at the University of California at Berkeley and he was also a lecturer, writer, and consultant. Petitioner Gloria Churchman (hereinafter Gloria or petitioner) was an artist who had been involved in artistic activities for 20 years. She mainly painted but also sculpted, designed, drew, and built; wrote short stories, poems, and songs, performed in films, and even made a film.
- In addition to an undergraduate degree, she had 2 ½ years of graduate work in psychology and 2 ½ years of work in art school. She had taught courses at San Francisco State College, at the University of California Extension, and the Mendocino Art Center as well as gave numerous workshops independently of any institution. During the years at issue, petitioner devoted a substantial amount of her time to her artistic activities and she held no other job except as a housewife.
- Petitioner did her artwork in a home studio which was built for that purpose.

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Continuing

- Petitioner maintained a mailing list of about 200 names of students, friends, customers of the art gallery which she ran, and members of organizations to which she belonged, including an art club. When she had a show petitioner sent an announcement of it to the people on such list. In addition, gallery shows were announced by the gallery through newspapers as well as the gallery's own mailing list.
- Petitioner began making posters and books in order to make her work more available to the public and more profitable, and she went to galleries in New York and San Francisco seeking to have her work shown there but she was largely unsuccessful. Such galleries, however, encouraged petitioner to go on with her work in the hope that it might one day be shown. At the time of trial, she was working on a book in which much of the work that petitioner had done in the past 20 years was reproduced and thereby made more available to the public.

And the Record Keeping?

- Petitioner kept a notebook in which she recorded what she has sold and to whom it was sold. Petitioner kept receipts of her expenses. She did not keep a separate bank account for her artistic activities nor did she keep a record of the occasional gifts of her work to friends and relatives.
- During the 20 years that petitioner had pursued her artistic activities, the income from the sale of her artwork had not exceeded her expenses in any year. Petitioner reported no art-related income whatsoever for the taxable year 1970 and 1971, but she reported \$250 of such income for 1972.
- So, she lost money for 20 years. Spoiler alert: She won the case! Why? Read on.

Bona Fide

- In order to prevail, the taxpayer had to show that she pursued her artistic activities during the years in question with the objective of making a profit. Sec. 1.183-2(a), Income Tax Regs.; **Hirsch v. Comm.**, 315 F.2d 731 (9th Cir. 1963); **Benz v. Comm.**, 63 T.C. 375 (1974); **Besseney v. Comm.**, 45 T.C. 261 (1965), affd. 379 F.2d 252 (2d Cir. 1967). Petitioner's expectation of profit need not be reasonable, but she must establish that she continued her activities with a bona fide intention and expectation of making a profit. **Jasionowski v. Comm.**, 66 T.C. 312 (1976); **Benz v. Comm.**, *supra*; **Besseney v. Comm.**, *supra*.
- Notice the clear phrase: Expectation of profit need not be reasonable. But there must be a bona fide intention and expectation of making a profit.

More from the Court

- Since petitioner has introduced no evidence of net profit derived from her artistic activities for any of the years 1970 through 1975, the section 183(d) presumption could not help her.
- Therefore, the court had to determine whether petitioner's activities were engaged in for profit by reference to all of the facts and circumstances of the case, including the relevant factors set forth in section 1.183-2(b),⁴ Income Tax Regs., and giving greater weight to objective facts than to the taxpayer's mere statement of her intent. Sec. 1.183-2(a) (b), Income Tax Regs.; **Jasionowski v. Comm.**, *supra*; **Besseney v. Comm.**, *supra*.

As a Whole

- Viewing the record as a whole, the court believed that petitioner had a bona fide intention to derive a profit from her artwork. There are admittedly factors in this case which indicate the absence of a profit motive. Petitioner had a history of losses, sec. 1.183-2(b)(6), Income Tax Regs.; she had never been dependent upon income from her artistic activities, sec. 1.183-2(b)(8), Income Tax Regs.; and there was a significant recreational element inherent in her activities, sec. 1.183-2(b)(9), Income Tax Regs.
- However, such a history of losses is less persuasive in the art field than it might be in other fields because the archetypal "struggling artist" must first achieve public acclaim before her serious work will command a price sufficient to provide her with a profit.⁵
- The other factors indicating an absence of profit motive are persuasive but they are outweighed by the facts demonstrating that petitioner did engage in her artwork for profit.

Jungian Archetypes

- My favorite line in the case is the following: **However, such a history of losses is less persuasive in the art field than it might be in other fields because the archetypal “struggling artist” must first achieve public acclaim before her serious work will command a price sufficient to provide her with a profit.**
- IRC 183 cases are frequently described as hobby loss cases. This expression, hobby loss, is not found in the Internal Revenue Code (but it IS found in the Regs). I object to the phrase hobby loss. The question is the following: Does the activity you are pursuing rise to the level of a trade or business? What some people do for a living can be, for others, a hobby. And what is for some a hobby, can rise to the level of a trade or business.

The Court Says

- While petitioner's artwork involved recreational and personal elements, her work did not stop at the creative stage but went into the marketing phase of the art business where the recreational element is minimal. Petitioner designed an art gallery and ran it for 1 year, she maintained a mailing list and sent announcements of her shows to persons on such list, she went to galleries in San Francisco and New York attempting to have her work shown, and she published a book. Furthermore, when petitioner saw that her paintings and other works were not selling well, she adopted new techniques, such as making posters and writing books, in an effort to make her work more available and more salable to the public. Although she did not keep a complete set of books pertaining to her artistic activities, petitioner kept all of the receipts for her art expenses and kept a journal recording what she sold and to whom. These facts indicated that petitioner carried on her artistic activities in a businesslike manner for profit. Sec. 1.183-2(b)(1), Income Tax Regs.

Marketing Phase

- Notice the court states: Her work did not stop at the creative stage but went into the marketing phase of the art business where the recreational element is minimal.
- Marketing implies business. If you have a hobby and you are doing whatever it is you enjoy, but you are not working to financially exploit it, then it is not a business. If you love playing guitar but you are not out there marketing, playing shows, marketing music, giving lessons, writing books, scoring films, if you just like to play your music, well, that is not a business. Similarly, with Churchman. It is not whether you win or lose, it is not whether you make money or lose money, it is **how** you play the game. The effort, the intention, the time, the focus, the monetary exploitation.

Education

- Moreover, petitioner studied art for 2 ½ years, she taught at the college level and in workshops, articles about her appeared in newspapers and magazines, her work was shown in commercial galleries at least once a year, some of her work had been sold, and she received a grant to make a film.
- These facts indicated that the taxpayer had the requisite training to become a successful artist. Sec. 1.183-2(b)(2), Income Tax Regs. The fact that she devoted a substantial amount of time to her artistic activities also indicated that she had a profit motive. Sec. 1.183-2(b)(3), Income Tax Regs.

Dedicated Artist

- It is abundantly clear from her testimony and from the objective evidence that the taxpayer was a most dedicated artist, craved personal recognition as an artist, and believed that selling her work for a profit represented the attainment of such recognition.
- Therefore, the taxpayer intended and expected to make a profit. For section 183 purposes, it was irrelevant whether she intended to make a profit because it symbolized success in her chosen career or because it is the pathway to material wealth. In either case, the essential fact remains that the taxpayer intended to make a profit from her artwork and she sincerely believed that if she continued to paint she would do so.
- Taxpayer victory.

Profit Could Be Made

- Petitioner had a relatively large inventory, she had considerable training, she devoted substantial time to her artwork, she sold some paintings in the past, and attempted to sell more.
- It is certainly conceivable, in the court's view, that it was possible that she would someday sell enough of her paintings to enable her to recoup the losses which had meanwhile been sustained in the intervening years. **Besseney v. Comm.**, *supra* at 274.
- Accordingly, the court held that the taxpayer's artistic activities were engaged in for profit so that section 183 was inapplicable and petitioner was entitled to deductions for her art-related expenses, under sections 162 and 165.

Summary: The Triangle of IRC Sections is 183, 162, and 262

- If it is a trade or business, then 162 applies. But you actually start with 183:
- **§ 183 Activities not engaged in for profit.**
 - (a) **General rule.**
 - In the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.
 - So, the key question is: Is it engaged in for profit? And this is determined by the facts and circumstances. Gather the information.

§162

- If it is a trade or business, see 183 discussion, then 162 applies.
- **§ 162 Trade or business expenses.**
- **(a) In general.**
- There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business
- 162 enables all ordinary and necessary expenses if you are carrying on a trade or business.

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§262

- 162 makes everything deductible, if it is ordinary and necessary.
- 262, however, provides:
- **§ 262 Personal, living, and family expenses.**
- **(a) General rule.**
- Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.
- The **Churchman** case is a great one for practitioners to cite as substantiation when defending clients on a hobby loss determination.

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Shri G. Agarwal, et ux. v. Commissioner, TC Summary Opinion 2009-29

- The issue on this case is IRC 469(c)(7), which would allow the full amount of the rental loss and not toss it into the suspended category.
- The taxpayer had Schedule E rentals, resulting in loss. Mrs. Agarwal worked full time as a real estate agent at Century 21.
- A. *The Parties' Arguments*
- Petitioners argue that real estate agents should be considered real estate professionals because real estate agents are engaged in a real property brokerage business in that real estate agents “bring together buyers and sellers”.
- In reply, respondent (the IRS) argues that Mrs. Agarwal was a licensed real estate agent, not a licensed real estate broker. Thus, under California law, according to respondent, Mrs. Agarwal could not be engaged in a brokerage trade or business, and therefore, she was not engaged in a real property trade or business as defined by section 469(c)(7)(C).

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469(c)(7)

- **(7) Special rules for taxpayers in real property business.**
- (A) In general. If **this paragraph** applies to any taxpayer for a taxable year—
- (i) **paragraph (2)** shall not apply to any rental real estate activity of such taxpayer for such taxable year, and
- (ii) **this section** shall be applied as if each interest of the taxpayer in rental real estate were a separate activity.

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More of 469(c)(7)

- Notwithstanding **clause (ii)**, a taxpayer may elect to treat all interests in rental real estate as one activity. Nothing in the preceding provisions of **this subparagraph** shall be construed as affecting the determination of whether the taxpayer materially participates with respect to any interest in a limited partnership as a limited partner.
- (B) Taxpayers to whom paragraph applies. **This paragraph** shall apply to a taxpayer for a taxable year if—

469(c)(7) Even More

- (i) more than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and
- (ii) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates.
- In the case of a joint return, the requirements of the preceding sentence are satisfied if and only if either spouse separately satisfies such requirements. For purposes of the preceding sentence, activities in which a spouse materially participates shall be determined under **subsection (h)**.

Real Property Trade or Business Definition

- (C) Real property trade or business. For purposes of **this paragraph**, the term “real property trade or business” means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.
- So, who gets to fully deduct their loss? Who is in the real property trade or business. In this case, specifically, what does brokerage trade or business mean?

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Facts More

- B. *Brokerage Defined* The term “brokerage” is not defined in section 469, within the legislative history of section 469, or by any court decision. Thus, the Court turns to principles of statutory construction to determine its meaning. See ***Baker v. Wash. Group Intl., Inc.***, No. 1:06-CV-1874 (M.D. Pa. Mar. 14, 2008); ***Sierra Club v. Leavitt***, 355 F. Supp. 2d 544, 555 (D.D.C. 2005); ***Weber v. Heitkamp*** (In re Hopson), 324 Bankr. 284, 287 (S.D. Tex. 2005). “Statutory words are uniformly presumed, unless the contrary appears, to be used in their ordinary and usual sense, and with the meaning commonly attributed to them.” ***Caminetti v. United States***, 242 U.S. 470, 485-486 (1917). In addition, a statutory term is construed “in its context and in light of the terms surrounding it.” ***Leocal v. Ashcroft***, 543 U.S. 1, 9 (2004); see also ***Jarecki v. G. D. Searle & Co.***, 367 U.S. 303, 307 [7 AFTR 2d 1585] (1961) (“a word is known by the company it keeps”). Legislatures are presumed to have intended that a statute’s terms “be given a ***Hazlett v. Evans***, 943 F. Supp. 785, reasonable construction”. 788 (E.D. Ky. 1996) (quoting ***D.L.C. v. Walsh***, 908 S.W.2d 791 (Mo. Ct. App. 1995)); see also ***Beck v. N. Natural Gas Co.***, 170 F.3d 1018, 1024 (10th Cir. 1999); ***In re Nofziger***, 925 F.2d 428, 435 (D.C. Cir. 1991).

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Webster Speaks

- A term's common or approved usage may be established by a dictionary. **Rousey v. Jacoway**, 544 U.S. 320 [95 AFTR 2d 2005-1716] (2005); **Smith v. United States**, 508 U.S. 223, 228-229 (1993). Webster's Third New International Dictionary 282 (2002) defines the term “brokerage” as “the *business* of a broker” or “the fee or commission for transacting business as a broker.” [Emphasis added.]

More

- The Court concludes that Congress is presumed to have defined the term “brokerage” in its common or ordinary meaning. The Court further concludes that for purposes of section 469, the “business” of a real estate broker includes, but is not limited to: (1) Selling, exchanging, purchasing, renting, or leasing real property; (2) offering to do those activities; (3) negotiating the terms of a real estate contract; (4) listing of real property for sale, lease, or exchange; or (5) procuring prospective sellers, purchasers, lessors, or lessees. See **Hooper v. California**, 155 U.S. 648, 657 (1895); **Lawrence Gas Co. v. Hawkeye Oil Co.**, 165 N.W. 445, 447 (Iowa 1917); **Schmidt v. Maples**, 289 N.W. 140, 143 (Mich. 1939); **Commonwealth v. Jones & Robins, Inc.**, 41 S.E.2d 720, 727 (Va. 1947); **In re Pipes**, 748 A.2d 118, 121 (N.J. Super. Ct. App. Div. 2000); **Commonwealth v. Fahnestock**, 15 Pa. C. 598 (Pa. Quar. Sess. 1895); see also Ky. Rev. Stat. Ann. sec. 324.010(1) (LexisNexis 2007) (defining “Real estate brokerage”); Md. Code Ann. Bus. Occ. & Prof. sec. 17-101(l) (LexisNexis 2004 & Supp. 2008) (defining “Provide real estate brokerage services”); Wis. Stat. Ann. sec. 452.01(3e) (West 2006) (defining “Brokerage service”).

Court's Conclusion

- *C. Application of the Definition to Mrs. Agarwal's Activities* As is relevant here, California law defines the term “real estate broker” as a person who does, or negotiates to do, any one of the enumerated activities for compensation. Cal. Bus. & Prof. Code sec. 10131 (West 2008). Similarly, California law also defines the term “real estate salesman” as a person who is employed by a broker and who does any one of the enumerated Cal. Bus. & Prof. Code sec. 10132 (West 2008). Whether Mrs. Agarwal is characterized as a broker or a salesperson for State law purposes is irrelevant for Federal income tax purposes—the test is whether she was engaged in “brokerage” within the meaning of section 469, as defined supra. Consistent with her real estate salesman's license and pursuant to her contract with the brokerage firm, Mrs. Agarwal was engaged in “brokerage”; i.e., she sold, exchanged, leased, or rented real property and solicited listings. Therefore, Mrs. Agarwal was engaged in a “brokerage” trade or business within the meaning of section 469(c)(7)(C).

Conclusion Concluded

- Because Mrs. Agarwal owned an interest in a rental property, performed more than one-half of her personal services in real property trades or businesses in which she materially participated, and performed more than 750 hours of services in real property trades or businesses in which she materially participated, she is a qualifying taxpayer. See sec. 469(c)(7); sec. 1.469-9(b)(6), (c)(1), Income Tax Regs. Because Mrs. Agarwal is a qualifying taxpayer and she materially participated with respect to each property,⁴ petitioners are entitled to deduct their 2001 and 2002 Schedule E losses. See sec. 469(c)(7); sec. 1.469-9(e)(1), (3), (4) *Example (i)*, Income Tax Regs.; sec. 1.469-5T(a), Temporary Income Tax Regs., supra (defining material participation); see also **Fowler v. Commissioner**, T.C. Memo. 2002-223 [TC Memo 2002-223]; **Shaw v. Commissioner**, T.C. Memo. 2002-35 [TC Memo 2002-35].

Further Notes

- The facts of the case go back to the years 2001 and 2002. The decision was issued on March 2, 2009. This issue, IRC 469(c)(7), is still very pertinent. In lecturing nationwide, I have had numerous occasions to hear stories on taxpayers in real property businesses (that is the language used in the Code).
- This was the first case in this controversial area. The question really turns on: How do you read and interpret the statute? The sentence which was up for grabs is:
- Real property trade or business. For purposes of **this paragraph**, the term “real property trade or business” means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

Controversy

- The IRS insisted that brokerage trade or business cannot mean a real estate agent. This rather constrained argument was refuted at the appeals level but the appeals agent refused to budge and the taxpayers litigated and won, BIG. Their EA, Mr. Frank Norton, did a spectacular job. I did my best, also.
- Justice Frankfurter said: Words mean what they mean by common English dictionary definition unless there is a specific definition provided by the legislature (my words, summarizing his thoughts). I’ve always been a fan of this teaching by Justice Frankfurter and this is how the Agarwal case was won.
- A term’s common or approved usage may be established by a dictionary.

From There to Here

- So, flash forward to the Tax Cuts and Jobs Act, IRC 199A.
- In that very fun Code Section, everyone gets a 20% reduction on Qualified Business Income.
- Permanently extended by the One Big, Beautiful Bill Act (OBBBA)
- Except for SSTBs.
- Oh, oh!!
- Here is the definition of SSTB:
- **199A(d)(2) Specified service trade or business.**
- The term “specified service trade or business” means any trade or business—
- (A) which is described in **section 1202(e)(3)(A)** (applied without regard to the words “engineering, architecture,”) or which would be so described if the term “employees or owners” were substituted for “employees” therein, or

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§1202

- **1202(e)(3) Qualified trade or business.**
- For purposes of **this subsection**, the term “qualified trade or business” means any trade or business other than—
- (A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,
- So, the question is: What is a brokerage service. Is it a SSTB? Or is it not a SSTB?

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SSTB or Not SSTB, that is the Question

- Due to Agarwal, look what Treasury has done. The SSTB definitions, and carve outs to the definition, are found in Reg § 1.199A-5. Specified service trades or businesses and the trade or business of performing services as an employee.
- If you go to 1.199A-5(b)(1)(ix) you will find: Brokerage services as described in paragraph (b)(2)(x) of this section.
- And, at 1.199-A-5(b)(2)(x), you will find:
- (x) Meaning of services performed in the field of brokerage services. For purposes of section 199A(d)(2) and paragraph (b)(1)(ix) of this section only, the performance of services in the field of brokerage services includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in section 475(c)(2)) for a commission or fee. This includes services provided by stock brokers and other similar professionals, but does not include services provided by real estate agents and brokers, or insurance agents and brokers.

Let's Look at that Again

- Does not include services provided by real estate agents and brokers, or insurance agents and brokers.
- Isn't it amazing? They specifically excepted real estate agents and brokers. In other words, Agarwal, decided March 02, 2009, going back to tax year 2001, LIVES.
- In the 1.199A regulations which are effective February 8, 2019.
- It is fascinating in regards to the SSTBs, to try to determine what the words mean.

For Example

- Meaning of services performed in the field of health. For purposes of section 199A(d)(2) and paragraph (b)(1)(i) of this section only, the performance of services in the field of health means the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals performing services in their capacity as such. The performance of services in the field of health does not include the provision of services not directly related to a medical services field, even though the services provided may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or the research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.

What About Out Patient Surgery Centers?

- The regs answer this. Before the regs came out, no one really knew the answer. And then the regs came out with a pro taxpayer answer. They are NOT an SSTB. They seem to be more in the nature of a rental. Which is a trade or business.
- Y operates specialty surgical centers that provide outpatient medical procedures that do not require the patient to remain overnight for recovery or observation following the procedure. Y is a private organization that owns a number of facilities throughout the country. For each facility, Y ensures compliance with state and Federal laws for medical facilities and manages the facility's operations and performs all administrative functions. Y does not employ physicians, nurses, and medical assistants, but enters into agreements with other professional medical organizations or directly with the medical professionals to perform the procedures and provide all medical care. Patients are billed by Y for the facility costs relating to their procedure and by the healthcare professional or their affiliated organization for the actual costs of the procedure conducted by the physician and medical support team. Y does not perform services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section.

Summary

- Maybe the title of this course is a bit much. And maybe not!
- Tax Cases That Will Save Your Clients Money
- The Agarwal case is a great case to teach you about IRC 469(c)(7). And the importance of Justice Frankfurter who teaches us an important lesson about statutory construction.

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Summary

- The Agarwal case not only saves your clients money but gives you courage. The Agarwals did litigate their case, and had the entire IRS against them. Mr. Norton and I helped the Agarwals and, ultimately, the IRS agreed that we **ARE** right and they are **WRONG** and just look at the 1.199A-5 Regulations validating our big win.
- The Agarwal case also protects our tax practice. You CAN take a position on the tax return if it meets IRC 6694. There must be reasonable cause.
- The Cohan case, along with SSTS Number 4, saves our clients money, especially in these days of virus. And it lets us know that we can survive an audit even if the client doesn't meet 100% retention of all documents. Circular 230, 10.34(d) speaks to us about reliance on client records.

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Summary

- Churchman, saves my clients money, and gives me courage and support and safety in case of an audit. In fact, when I taught lay groups, consisting of artists, I taught Churchman. It is a very sensible and readable case.
- And Harary, well, who doesn't like a case about an accountant who not only bribes the IRS but also steals money from his client in the attempt to bribe the IRS.
- Take away from that case: Don't bribe the IRS and expect to continue to remain in business.
- I hope these cases are as meaningful to you as they have been for me.

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*Thank you
for joining us today.*

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Overview of Supplemental Material

- Presentation reviews landmark U.S. tax cases that shape practice standards, taxpayer rights, and professional ethics.
- Focuses on using judicial precedent to defend deductions, establish profit motives, and ensure ethical conduct in tax representation.

Key Cases and Lessons

1. Cohan v. Commissioner (1930)

- Established the **Cohan Rule**: taxpayers may estimate deductible expenses if credible evidence shows they were incurred, even without full documentation.
- Courts may allow reasonable approximations rather than deny all deductions.
- Limitations: **IRC §274(d)** now disallows estimates for travel, gifts, meals, and listed property.
- Reinforces AICPA SSTS No. 4—estimates are permissible when reasonable and clearly presented.

2. Churchman v. Commissioner (1977)

- Defined standards for **profit motive** under **IRC §183 (Hobby Loss Rules)**.
- Artist with 20 years of losses was found to have a bona fide business because of her **professional conduct, marketing efforts, and persistence**.
- Clarified that **losses alone do not disprove a profit motive**—facts and circumstances determine intent.
- Highlights interplay of **§183, §162 (business expenses), and §262 (personal expenses)**.

3. Agarwal v. Commissioner (2009)

- Held that a **real estate agent** qualifies as engaged in a “**real property trade or business**” under **§469(c)(7)**.
- Allowed full deduction of rental losses, rejecting the IRS’s narrow view of “brokerage.”
- Influenced **§199A regulations**, which later **explicitly excluded real estate agents and brokers from the SSTB limitation**, validating the case’s interpretation.

4. Harary v. Blumenthal (1977)

- Centered on **Circular 230 §10.22 (Due Diligence and Honesty)**.
- Practitioner disbarred for **misrepresenting payments to a client** in an IRS matter.
- Reinforces ethical duty of **truthfulness, diligence, and client loyalty**—dishonesty leads to disciplinary action under **31 C.F.R. §10.22(c)**.

Ethical and Professional Standards

- **31 U.S.C. §330** empowers the Treasury to regulate practitioners before the IRS.
- **Circular 230 §10.22**: Practitioners must exercise due diligence and may rely on others' work only with reasonable care.
- **AICPA SSTS 2.4** allows use of client estimates if practical, truthful, and not misleading.
- **Williams v. United States** emphasizes the need for credible effort—courts cannot estimate deductions without sufficient evidence.

Key Takeaways

- **Cohan**: Courts allow reasonable estimates—document when possible, estimate honestly when not.
- **Churchman**: Profit motive depends on behavior, not profit history—conduct businesslike.
- **Agarwal**: Statutory interpretation matters—plain meaning and common usage protect taxpayers.
- **Harary**: Ethics are nonnegotiable—honesty and diligence safeguard practitioners and clients.
- Together, these cases “**save money, give courage, and protect your tax practice.**”

GROUP STUDY MATERIALS

A. Discussion Questions

1. Why is the Cohan Rule still relevant for practitioners today?
2. What lessons does the Churchman case teach about the hobby loss rules?
3. What ethical responsibilities are highlighted by the Harary case?

B. Suggested Answers to Discussion Questions

1. Why is the Cohan Rule still relevant for practitioners today?

The Cohan Rule remains relevant because real-world clients often face imperfect recordkeeping. Fires, lost receipts, or faded documents can make complete substantiation impossible. The rule provides a pragmatic framework that balances fairness with compliance—it allows deductions based on credible evidence and reasonable estimation, while reminding practitioners to document and justify such estimates carefully. Today’s preparers can apply the Cohan principle ethically by obtaining credible client testimony, corroborating it with industry norms, and maintaining explanatory notes. However, certain expenses—like travel, meals, and gifts under IRC §274(d)—still require strict documentation. The rule, therefore, highlights the dual responsibility of professional judgment and adherence to substantiation rules. It continues to serve as a reminder that the tax system values honesty and reasonableness over rigid perfection.

2. What lessons does the Churchman case teach about the hobby loss rules?

The *Churchman* case teaches that intent and businesslike behavior matter more than profitability alone. Even though the taxpayer suffered losses for 20 years, she demonstrated a genuine profit motive through consistent effort, professional development, and marketing activities. The case underscores the importance of maintaining books, seeking expert advice, and operating in a manner consistent with for-profit ventures. It also cautions the IRS and practitioners not to judge a business solely by financial outcomes, especially in industries—like art—where profitability can take years. For practitioners, *Churchman* reinforces the need to document their clients’ business intent and operational structure to withstand scrutiny under Section 183.

3. What ethical responsibilities are highlighted by the Harary case?

The *Harary* case underscores that ethical violations often stem from dishonesty, not just technical tax errors. The practitioner’s downfall was not bribing an IRS agent—he was acquitted of that—but lying to his client about the bribe amount. This deception violated Circular 230’s fundamental principles of honesty and integrity. Tax professionals must maintain transparency with clients, avoid conflicts of interest, and ensure all representations to the IRS and taxpayers are truthful. The case illustrates that ethical integrity is inseparable from technical competence. Even the appearance of impropriety can erode trust and lead to disciplinary action. Ultimately, the lesson is clear: ethical behavior protects both the client and the practitioner’s professional standing.

PART 2. BUYING AND SELLING A BUSINESS

A Practitioner's Guide to Buying and Selling a Business

The sale or purchase of a business is one of the most consequential transactions an owner or investor will ever undertake. Each side—buyer and seller—approaches the deal with distinct, often conflicting objectives, which can make the process both complex and strategically significant. In this program, the presenter walks through the major issues that influence business acquisitions, from choosing between a stock sale and an asset sale to understanding the implications of corporate reorganizations and due diligence requirements. Drawing on real-life examples, the discussion illuminates how tax law, financing structure, state and local regulations, and even interpersonal factors like goodwill can dramatically impact the financial and legal outcomes of a transaction. The session brings a practical focus to the technicalities of Sections 1060, 338, and 754, and offers deep insight into how experienced professionals can protect their clients' interests while identifying opportunities to minimize tax exposure and mitigate risk. Whether you represent buyers or sellers, this program provides an indispensable framework for understanding the core issues driving business transfer decisions.

Hi everybody, welcome to the program. Today we're going to talk about issues in the sale and purchase of a business. And there are a number of different issues depending on whether you're with the buyer or you're representing the seller in the transaction.

Buyers and sellers often have very adverse interests when it comes to a acquisition of a business. So they're not generally on the same page, but they can be. And one of the things we can do is try to get to them to being on the same page.

Now, adversity, obviously, when the parties are adverse, it can create complexities in determining the form. Is it a stock sale? Is it an asset sale? Is it an acquisitive reorganization? And again, there can be different considerations depending on the entity. Is the selling entity a partnership, an LLC, a sole proprietorship, a corporation, an S corporation? What about the buyer?

And so, all of these can create different issues and complexities. Well with complexities, there's always potential advantages, right? We know that that can happen that when we have a something that can be complex, we have potential advantages for our clients.

One of the things that I have found in general is my clients will say, that sounds good, but show me the money I want the money. You can come up with all these great things, but I want the money. It's not usual, but it can happen. I had a deal where I was representing a client and we were selling his business to this publicly traded company and he had a small corporation.

They wanted to take it over to kind of get into that business. And they were a high flyer, they were great. They were written up in the trade magazine as being the high flyer, the second largest in the world in this particular field. They had just done a takeover. They were number four. They had a takeover of number two. So they became number two. And they came in and they, I suggested to the client, we're selling this for 10 million. You have a \$5,000 basis. Maybe we should look at some options here.

It's a publicly traded company. Maybe we can do a corporate reorganization. you know, looking at areas that we could reduce that large tax burden on my client. The seller said, or the buyer, excuse me, said, nope, cash deal. Cash deal, we'll wire the cash into your client's account, that's it. So, okay, that's it. It's a cash deal, not a great tax. implication on that one but that was the driving force. If you want to sell it, it's a cash deal.

Now, six months after the acquisition, the buyer ended up going into bankruptcy. They were taken off the exchange.

And then my client ended up buying one of the parts of the business he had sold back from the bankruptcy so actually it ended up a great deal for my client. But again, the seller drove it and my client just said, I want to sell it, this is a great deal. So let's do it. So sometimes that's going to drive the transaction.

How badly does the seller want to sell? And what is the buyer willing to do? So things the buyer may want to consider, things like the asset basis, long-term plans for the business, goodwill and going concern value, the ability to transfer licenses, leases, loans, that becomes really important.

The type of business to use after the acquisition. And there can be different issues to consider. So the seller may want to consider other issues such as do I want ordinary income, capital gain, possibly investing in opportunity zone to defer some of the income recognition, selling this 1202 exclusion going to apply.

If there's a loss, it's 1244 available to get a \$50,000 or \$100,000 on a joint return deduction. So lots of issues. In addition, the buyer may want to consider, are there NOLs here that I have to consider that may be subject to limitations?

What's the value of the business? At one time, businesses were advertising in the Wall Street Journal NOLs, that's all they had I mean that was the value of the company was the NOLs that you could get. Well, then the government came in with section 382 and said, okay, but we're going to limit the amount of NOLs that you can purchase from a company.

So, one of the key things is the due diligence. You have got to do due diligence. It's extraordinarily important. The value of assets that aren't included for example in the sale: the tangible assets. What's the value of the assets? What's the value of any intangibles, patents, copyrights?

The going concern value. Is it all cash? Is it an installment? If it's an installment, one of the things we don't think about is we got to do due diligence to make sure that our client, if we are the seller, are we going to be able to get our money? In other words, is the buyer going to be able to actually make the future payments?

If it's gonna be a reorganization, how marketable is it? Being a minority owner in a closely held business, I've had clients come in and say, we're going to merge and I'm going to end up getting 40%. Well, 40% in a closely held business doesn't give you a lot of power and there is certainly a lot of danger.

What are the risks that are involved in the industry, the current risks, the projections of future value and risks? You know, if you're buying something in an industry that is changing dramatically, mainly say in technology, then what is the value and what is going to be the cost to bring this technology in this company up so that it is going to be valuable in the future?

I owned a tech company at one time that at the time we were 20 steps ahead of the competition. We were five steps ahead of the relatively existing technology in the sense of what was out there and considered commonly available. Well, it didn't take long for what we were doing to become commonplace, thereby driving the costs down and the amount of money to put in to move to the second stages of that, or third stages, I guess I should say, of that technology was tremendous. And so those were all considerations. Ended up selling it to a company that had the resources to take it to the further levels.

So again, things you need to consider. One of the things that we often don't think about is do state and local taxes apply, for example? Does a sales tax apply? Is this sale of the corporation, if it has real estate, is that considered a disposition of the underlying real estate subject to a transfer tax on that?

New York is famous for that type of thing. Depending on what we're selling, are we selling assets, as I said, that might be subject to sales tax? Are there other issues that are out there?

And then the legal issues, the licenses, the leases, the contracts, can they be transferred? That's one thing that's important in the due diligence. We can't just assume that the landlord is going to say, yeah, you just take over the contract. Now, if it says in the contract that, it can be transferred then fine. But, if it doesn't then you're kind of at the mercy of the landlord. The landlord could come in and go sure well, you know, we'll extend the lease with you, but at five times the rent.

You know what is the value of that? What about contracts? Can the contracts be assigned. If not, well then what are you getting with those contracts?

Licenses. Can the license be transferred? I had a client that was, he would go around and buy insurance, certain insurance agencies. Well, what he was doing was he'd have to buy it. We'd have to make sure we bought it, that the entity couldn't change. So in the transaction, because many of the licenses that they had to sell real estate with various companies, you couldn't transfer those. So it's not like they could just come in, take over the agency, and transfer the contracts with the insurance companies so that they could sell that insurance.

And so, there were a number of different gyrations that had to be gone through to do that. In some cases, you just can't sell. You can't transfer the license. So how are we going, what type of transaction are we going to enter into? Well, obviously that company has to exist, right? And so a stock sale, maybe a triangular reorganization where the company that is the target, continues to exist or a reverse merger where the target continues to exist so there's options in ways to do it, but these are things that we often overlook.

And they are incredibly important to do in the due diligence So let's just say a general rule. Sellers want capital gain. Buyers want to step up in basis, so they generally want an asset sale. Now, that's a general rule, but that tends to be true. The method of financing the acquisition often determines how the acquisition is effectuated.

You have to determine how the acquisition. Is it going to be cash, notes? Is it going to be stock, is it going to be buyer's common stock or buyer's preferred stock? If it's going to be stock, then it could allow for a tax-free reorganization. We'd have to look then. and see under Section 308, is this going to qualify as a tax-free reorganization? How can we structure it? How we can structure that, well, let's go back. The target has licenses that can't be transferred.

Then we have to structure it so that at the end of the day, there is going to be either a reverse merger where the target survives. But is that the situation where the seller says, I'm not going to go away. Then what you'd have to do is do a transaction where you end up with a parent sub situation at the end of the day. That way the licenses aren't being transferred. But again, is that how you want to operate the business?

Now, if the buyer is foreign or from out of state, debt financing could require withholding taxes. And when you start looking at debt financing, then you have to look at section 163J and the amount of the current interest limitations. In addition, thinly capitalized businesses may have debt re-characterized as equity.

So, one option that we have, the buyer pays the issuing with promissory notes. So, the buyer is going to issue promissory notes and that way the sellers can generally report capital gain. The promissory note, is not payable on demand and any stock sold is not publicly traded. So in the installment sale, the seller shareholders report the proportion amount of gain as they collect the purchase price. But again, need to do due diligence on the ability of the seller to actually make the payments. And this becomes even greater when our purchase price is contingent on the future profit from the entity.

And this may be very true if there's an intangible like a patent or a copyright. Part of the purchase price is the value of that. What income is going to be obtained from that? Because once you start doing that, you end up in all sorts of problems. The IRS wants closed transactions. The IRS wants you to value that future amount from the contingency and say, okay, it's a closed transaction.

If you collect more, there's more income. If you collect less, take a deduction. But you've got to have some type of due diligence to say, okay, they really can meet these goal posts.

Now in the sale of a sole proprietorship, let's look at that first. A sole proprietor is not a separate entity from its owners legally for tax purposes. So, it's an asset sale. And therefore, the nature of the gain or loss is going to follow the character of the underlying asset. Ordinary, like receivables, inventory, depreciation, recapture, 1231 can apply. And then possibly capital gain then on the balance, but it will again it requires the transfer bills of sale and deeds. Watch out because there could be an acceleration of notes. And this is something in general.

So, let's say you're taking over the company, but could that trigger an acceleration of notes that the seller has. So, the buyer comes in and, all of a sudden, creditors come in and go, okay we're calling due those notes.

Wait, you're calling due the notes? Hey, we have an acceleration clause in that agreement. Due diligence; again, make sure the licenses can be transferred, possible sales tax, transfer tax. Then again, if the buyer, if it's not cash, what is the security for the seller?

So again, the buyers purchasing the assets are going to get a step up or step down in basis and the holding period starts new for them. And then the seller must transfer the assets, bills of sale, deeds. Watch out for assets with liens. Make sure that there's been a UCC or lien search that was done.

What about workforce contracts that are in existence? What, is there a triggering event? if the business is sold and possible, again, as I said, state sales or transfer taxes.

So the buyer generally does not inherit any of the past income tax liabilities associated with the business acquired when it's a sole proprietorship. And the liabilities generally then will stay with the seller. Generally, non-income tax due diligence sales, use, property is the primary focus of the due diligence. So often, and this happens quite often, the seller will incorporate in anticipation of a sale, then try to sell the stock. That way getting capital gain.

The incorporation is generally tax free under 351. Basis carries over. The goodwill and other intangibles generally have a 15-year straight-line life for tax. And again, the holding period is going to carry over only to the extent of capital and 1231 assets.

So, if it's a sale shortly thereafter the incorporation, you can end up with short-term capital gain. And again, the other issues still exist. The one thing that before we move to any other, because it starts here, but it's in every transaction, is section 1060. 1060 is an applicable asset acquisition. Doesn't matter what type of entity it is, from sole proprietorship, partnership, corporations.

In the case of an applicable asset acquisition for the purposes of determining both the transferees basis and the gain or loss of the transferor so the consideration for the assets is allocated among the assets and it's allocated in a similar matter as section 338(b)(5).

So the buyer and seller again generally have adverse interest in the purchase price, right? The buyer wants as much as possible of the assets to be recovered as quickly as possible. Again, through depreciation, bonus depreciation perhaps, section 179. The seller, or five-year assets, rather than 39, depreciable assets or amortizable rather than capital.

The seller wants as much as possible to go on capital gain. In general, the IRS is going to recognize the party's allocation because their interests are adverse. Since you've got an adverse interest, well, you know, obviously you're going to come up with something that is reasonable and more likely to recognize the actual fair market value because, again, adverse interest, right?

I want a step-up in basis. I want this quickly to be able to write off my purchase price. Well, that's the buyer. The seller says, I want capital gain. I want as much on capital gain as possible. So I'd like all of the purchase prices, if I can, to be allocated to assets that would generate capital gain for me.

So that's a general concept. We'll talk about it a little bit further in the future. But it applies to all assets, all stock sales. Sales of a business, 1060 is going to apply.

All right, let's look at the sale of the partnership now. And, the buyer and the seller, again, still have those adverse interests. The purchase of the partnership interest, the purchase of the entire partnership, a contribution of capital by a new partner. I'm going to become a new partner, so I'm just going to contribute capital versus I'm going to buy the partnership interest from someone.

Those are two different things. So the transfer of an interest, the seller, the sale or exchange of the partner's interest in a partnership generally results in capital gain. Now there's some major exceptions for unrealized receivables and inventory, the so-called hot assets under section 751.

They require the seller to say if the partnership disposed of all its assets and then distributed out what would be my share that would come through to me just before I sold, what would be the ordinary income? Now, inventory is clear, right? But unrealized receivables, that includes essentially any item that would create ordinary income. So even depreciation recapture, that has to be picked up. And this all has to be picked up in the year of sale. Very unusual provision because what you do is you pick up the ordinary income.

By the way, I should mention that inventory in a distribution, inventory is only hot, if the fair market value exceeds 120% of basis. In a sale, all inventory is hot. So that 120% rule doesn't apply. So, what you do here is you pick up all the ordinary income in the year of sale. And then you offset it with a capital gain or loss. Let's say, just a simple example, you sold your partnership interest at \$1,000 loss. But your share of the ordinary income items, the 751, your share is \$7,000.

Well, you're going to take \$7,000 of ordinary income in the year of sale. How do you get to a thousand dollar loss? Because that's what you actually had, economically you had a thousand dollar loss. You're going to offset with now by taking a capital loss of \$8,000 netting to \$1,000 loss.

Unfortunately, let's assume that's all you had. You have the \$3,000 loss limitation on capital losses and so you'd pick up \$7,000 of income and deduct \$3,000 of loss. Now, yes, you get to carry it over, but in the year of sale, you're actually going to have \$4,000 of net income. Now, make it worse, add more zeros, right? \$70,000 ordinary income items. You take a \$71,000 loss to get to your \$1,000 loss, right?

Well, wait a second, you can only deduct \$3,000. So that \$71,000 loss, you take \$3,000 of it this year and carry the rest over. Well, wait a second. You've now got \$67,000 of net income, ordinary, in the year of sale. That's just the way it is.

And again, add more zeros, it gets even worse, right? So hopefully you have capital gains to offset that in the year of sale. so that you don't end up in that situation. Remember that, and this is very common, the selling partner is relieved of liabilities. If they are relieved of liabilities, then that is considered part of the purchase price for the seller.

So again, the hot assets, that's a major consideration to look at. That ordinary income element, even if you had a loss, you got to pick that up into income. unrealized receivables, as I said there, they're actually deemed receivable, so they're receivable as we normally think of them, but it includes accounts receivable, obviously, for a cash method.

But the right to payment for works or goods begun but incomplete. The basis for unrealized receivables includes the cost and expenses that were previously paid or accrued but not taken into account under the method of accounting. But there's a whole list of things that we don't even think of as receivables.

I've put up a slide here for you and the slide, as you can see, a lot of things you'd never think of. would be included in these deemed receivables. Mining property for which explorations were deducted. Certain farmland for which expenses for soil and water. Franchises, trademarks, trade names, oil, gas, geothermal. Lots of different types of things.

And then inventory includes additional property. Again, you can see it's not your normal understanding of inventory. So basically, think of it as anything that would create ordinary income.

Now, notification. This is, got to make sure it's done. If a partner exchanges, this would be the selling partner. If the partner exchanges a partnership interest attributable to unrealized receivables or inventory. must notify the partnership in writing. So the notification of the partnership has to be done within 30 days of the transaction or if earlier, January 15th of the calendar year following, if earlier, following the calendar year of the exchange.

The partnership has to file form 8308 once it's received the notice of a 751A exchange. Now, the partnership is deemed to have notice when either the partnership receives the written notification of the exchange from the transferor that includes the names, addresses of both parties, identifying numbers of the transferor, and if known, the transferee and the date of the exchange.

Or, the partnership has knowledge, which I mean if a partner's sold an interest, I'm pretty sure you're going to have knowledge of that. Now, no statement is going to be required if the transfer is, for example, a gift. Then again, that statement in this kind of look, at the form, you know, the date of the exchange, the amount of any gain or loss attributable to unrealized receivables, the amount of any gain or loss attributable to capital gain. So again, the partnership though, because this is going to matter to the partnership for reporting, the partnership can rely on the statement that the partner was not a 751 exchange unless the partnership has knowledge to the contrary.

So, if the partnership's in doubt, whether the partnership property constitutes unrealized receivables or inventory, or whether the transfer constitutes a 751A exchange, you can file the 8308 to avoid the risk of incurring any penalties for failure to file. So again, the 8308 is filed with Form 1065 for the year that includes the last day of the calendar year in which the exchange took place. Again, form 8308.

Now, one of the things that will be considered here is whether or not the partnership has a 754 election. The 754 election allows the incoming partner to adjust their inside basis of the assets to reflect their outside basis. And bonus depreciation can apply to that increase in basis. So, the adjustments though, and these are under, section 754 which is the election to make the adjustments, the adjustments are 734 for distributions and 743 for sales. You'll have to elect both.

But the 743B adjustment, this one is not reflected in the capital account. Now, the schedule B, of Form 1065 will ask a number of questions about a 754 election. Do you have it? Is it not revoked? Did you make an optional basis adjustment under 743? That's question B. If yes, attach a statement, but it asks you for the total aggregate positive or total aggregate negative adjustments. and then attach a statement with the computation.

Now the statement, the name of the transferee, the EIN or social security number of the transferee, the computation of the 743 adjustment, and the identity of the partnership properties that the adjustment was made to.

A corporate seller: Sellers always prefer capital gain and so they want to set stock sale Purchasers want an asset sale, limit the liabilities assumed, choose the assets that they can want to acquire, and get a step up in basis for depreciation and amortization.

Another thing that the seller likes is being relieved of liabilities because the corporation carries over the liabilities, and that's especially true of any contingent liabilities. So one of the advantages of doing business as an S is avoiding the two levels of tax unless the built-in gain applies. So the built-in gains tax generally applies to S corporations that converted, so converted from a C, and it can be assessed any time during the five-year period ending on the first day.

So, it's imposed at the highest corporate rate, which is 21%, and it's triggered by a disposition of any asset that was on hand at the time that the S-selection became effective. So an asset sale could trigger potentially the built-in gains tax if it was in the first five years after the conversion. But the buyer doesn't get that step up in basis. The buyer is going to want an asset sale because the asset sale, they can pick and choose what assets they want to buy. They get a step up in basis. The seller is going to have to recognize, again, ordinary income on the sale of assets that generate ordinary income, receivables, inventory, recapture, et cetera.

And so therefore, they would prefer to have a stock sale. Now, if you have patents, copyrights, other similar intangibles, it must make a specific allocation if an increase or decrease in the consideration is a result of a contingency that directly relates to the income produced by the intangible. And the specific allocation rule does not apply. The taxpayer could make any allocation of increase or decrease that would apply to any other assets.

One of the things that we're going to look at is goodwill. When you have a corporation, one of the issues you have to determine is, is the goodwill corporate or personal? If it's personal, it's capital gain. So personal goodwill can be deemed an asset of the corporation where the shareholders have transferred the goodwill to the corporation through non-competition, employment, or other agreements.

Now, you have to determine if personal goodwill exists. So a separate sale of shareholders' personal goodwill can result in the sale and be taxed at long-term capital gain rates. So personal goodwill exists when the shareholders' reputation, expertise, contacts contribute significantly to the company's value or future stream of income. So again, it's more likely to be associated with a business that's technical, specialized, professional, and have few customers.

So, the main cases, Martin Ice Cream is the leading case in personal goodwill. It's almost always cited by taxpayers and the IRS. In that case, the tax court held that when a corporation has no employment contract with an employee, in this case, that would be the owner selling, the employee's personal relationships are not corporate assets. So Arnold and his son Martin owned all of the stock of Martin ice cream, a distributor. Before going into business with his son, Arnold had worked for more than a decade in his own wholesale ice cream business, where he developed strong relationships with a number of managers and owners of supermarket chains.

Shortly after launching Martin Ice Cream, Arnold was approached by Haagen-Dazs, which wanted Arnold to introduce the company's ice cream to its supermarkets. The \$1.4 million purchase was two assets. Arnold's personal relationships and Arnold's agreement with Haagen-Dazs. The court held that these could not be attributed to the corporation because Arnold never had a covenant not to compete or an employment agreement. This is something to consider even in the beginning. Do you have covenants not to compete or employment agreements?

In Howard, a dentist was the sole shareholder, officer, and director, but for some reason entered into an employment agreement and a covenant not to compete with his own corporation. And so when he sold his practice for a little over half a million dollars, he was applying that to goodwill. The court held that the goodwill was sold was a corporate asset and belonged to the corporation.

Section 1060. You're required to apply Section 1060 anytime, as I said, there's an applicable asset transaction, which is assets which constitute a trade or business and with respect to which the transferee's basis is determined by reference to the consideration that it paid. And so therefore, you are required to allocate under Section 1060; you are required to allocate to seven assets.

Class one: cash, general deposit accounts. Two: actively traded personal property, including CDs, et cetera. Class three: assets that the taxpayer marks to market. Class four: stock in a trade of the taxpayer or property of a kind that would properly be included in inventory. Class five: all other assets than class one, two, three, four, six, and seven. So, furniture, fixtures, building, land, equipment, which constitute all or part of a trade or business are class five. Class six: all section 197 intangibles. Class seven, goodwill going concern value.

When you allocate, you allocate on the residual method, which means you allocate first to class one. Now you allocate first to class one, air market value. Class two: fair market value. You allocate fair market value to each class and whatever's left, the residual, goes to goodwill and going concern value.

Now, you go back and you allocate to each of the assets within each class based upon fair market value. So, the fair market value overall is allocated to the class, and then you allocate to the assets within the class.

Now, both parties, buyer and seller, are going to be required to file an 8594. The 8594 asset acquisition statement, you provide, both parties are filing this, the aggregate allocated to each class and the allocation of the sales price. You're then going to be asked. Was there a written document that allocates this? You should always in your contract, the buy-sell contract, you should have an attachment where the parties agree on these numbers. Now since you're both filing this, what is it going to happen if you both file different numbers?

Well, I'm going to file numbers that are more favorable to me, right, because I'm the buyer. The IRS will look at these and they will say, okay, these don't match. What's going on? So you would like to be able to exchange the 8594s to make sure they're consistent. However, if they're not consistent, at least you can protect yourself by making sure you have the same information in the addendum or the, I shouldn't say addendum, I'm sorry, the exhibit. to the buy-sell agreement. Here's our allocation, and you just go right through, class one, class two, class three, class four.

Now, they don't ask it to the assets within each class. They ask you for the aggregate. But they do ask you if you purchased a license or a covenant not to compete or entered into a lease agreement, an employment contract, management, or similar arrangement with the seller. If yes, attach a statement that specifies the type of agreement, the maximum amount of consideration. What are they concerned with? That you're going to disguise part of the compensation in the sale as an employment contract.

Covenant not to compete employment contracts, thereby taking a current deduction. Is that really part of the purchase price and should be considered in the allocation on the 8594? So cover yourself in that situation. Now, you could do a number of types of reorganizations if you chose to go that route. That's a whole other program in itself, the different types. For the most part, I don't find in practice. Most of the time, my clients, when they're the sellers, show me the cash. I want to be cashed out. I don't want to continue with this whole type of thing. A number of issues to consider, a number of issues to talk through with our clients. I want to thank you for joining me today and please, as always, be safe.

Hot Assets – Section 751

- Unrealized receivables also apply to assets that would create ordinary income if sold at its fair market value on the date of the payment. Including:
 - Mining property for which exploration expenses were deducted
 - Stock in a domestic international sales corporation (DISC)
 - Certain farm land for which expenses for soil and water conservation or land clearing were deducted
 - Franchises, trademarks, or trade names
 - Oil, gas, or geothermal property for which intangible drilling and development costs were deducted
 - Stock of certain controlled foreign corporations
 - Market discount bonds and short-term obligations
 - Property subject to recapture of depreciation under sections 1245 and 1250

1

Inventory items

- Inventory items are not limited to stock-in-trade of the partnership but also include the following property
 - Property that would properly be included in the partnership's inventory if on hand at the end of the tax year or that is held primarily for sale to customers in the normal course of business
 - Property that, if sold or exchanged by the partnership, wouldn't be capital asset or Sec. 1231 property
 - real or depreciable business property held for the long term holding period
 - Sec. 1231 netting process at the owner level

2

Inventory items

- For example, accounts receivable acquired for services or from the sale of inventory and unrealized receivables are inventory items
- Property held by the partnership that would be considered inventory if held by the partner selling the partnership interest or receiving the distribution
- In a distribution inventory is “hot” if the FMV exceeds 120% of basis while in a transfer all inventory is “hot”

3

Classes of assets: Class I assets

- Cash and general deposit accounts (including savings and checking accounts) other than certificates of deposit held in banks, savings and loan associations and other depository institutions

4

Class II assets

- Actively traded personal property, including certificates of deposit and foreign currency even if they are not actively traded personal property
- Class II assets do not include stock of seller's affiliates, whether or not actively traded, other than actively traded stock
- Examples of Class II assets include U.S. government securities and publicly traded stock

5

Class III assets

- Assets that the taxpayer marks-to-market at least annually for federal income tax purposes and debt instruments (including accounts receivable)
- However, Class III assets do not include:
 - Debt instruments issued by persons related at the beginning of the day following the acquisition date to the target under section 267(b) or 707;
 - Contingent debt instruments subject to Regulations sections 1.1275-4 and 1.483-4, or section 988, unless the instrument is subject to the noncontingent bond method of Regulations section 1.1275-4(b) or is described in Regulations section 1.988-2(b)(2)(i)(B)(2); and
 - Debt instruments convertible into the stock of the issuer or other property

6

Class IV assets

- Stock in trade of the taxpayer or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business

7

Class V assets

- All assets other than Class I, II, III, IV, VI, and VII assets
- Furniture and fixtures, buildings, land, vehicles, and equipment, which constitute all or part of a trade or business are generally Class V

8

Class VI assets

- All section 197 intangibles (as defined in section 197) except goodwill and going concern value
- Section 197 intangibles include the following assets listed here:
- <https://www.irs.gov/instructions/i8594>
- Section 197 assets do not include the assets listed here:
<https://www.irs.gov/instructions/i8594>

9

Class VII assets

- Goodwill and going concern value (whether or not the goodwill or going concern value qualifies as a section 197 intangible)

10

Overview of Supplemental Presentation

- Examines the **tax, legal, and strategic implications** of buying or selling a business.
- Focuses on how transaction structure—**asset sale, stock sale, or reorganization**—affects both buyer and seller outcomes.
- Emphasizes due diligence, goodwill valuation, and proper allocation of purchase price.

Key Transaction Structures

- **Asset Sale:** Buyer acquires individual assets; gains a basis step-up; seller may face ordinary income on some items.
- **Stock Sale:** Buyer acquires ownership interests; seller generally recognizes capital gain; buyer does not get asset basis step-up.
- **Reorganization:** Can enable **tax deferral** if structured under IRC §368.

Tax Code Sections

- **IRC §1060:** Requires allocation of purchase price among seven asset classes using the residual method.
- **IRC §751 (“Hot Assets”):** Unrealized receivables and inventory produce ordinary income on sale of a partnership interest.
- **IRC §754:** Allows adjustment of inside basis to match outside basis when a partnership interest changes hands.

Buyer and Seller Goals

- **Buyer:** Prefers an asset sale for depreciation and amortization benefits.
- **Seller:** Prefers a stock sale to achieve capital gain treatment and avoid double taxation.

Goodwill Considerations

- **Corporate goodwill** belongs to the company and is taxed as part of the entity’s sale.
- **Personal goodwill** belongs to individual shareholders when derived from personal reputation, skills, or relationships (as in *Martin Ice Cream*).

Built-In Gains (BIG) Tax

- Applies to **S corporations that converted from C status**.
- Triggered on sale of assets held at conversion if sold within **five years**.
- Taxed at **21%** (corporate rate).

Due Diligence and Valuation

- Includes verifying licenses, contracts, liabilities, and state tax exposure.
- Identifies nontransferable assets or agreements requiring renegotiation.
- Ensures accurate valuation of tangible and intangible assets.

Asset Classes under §1060

- 1. Cash and deposit accounts**
- 2. Actively traded personal property**
- 3. Marked-to-market assets and debt instruments**
- 4. Inventory and stock-in-trade**
- 5. Fixed assets (e.g., land, buildings, equipment)**
- 6. Section 197 intangibles (except goodwill)**
- 7. Goodwill and going concern value**

Key Takeaways

- Proper structuring minimizes taxes and risks for both parties.
- Allocation agreements should be documented and consistent between buyer and seller.
- Fair market value, business purpose, and documentation are essential for compliance.

GROUP STUDY MATERIALS

A. Discussion Questions

1. Why do buyers and sellers typically have adverse interests in structuring a business sale, and how can advisors mediate these differences?
2. How does due diligence impact the success of business acquisitions?
3. What role does goodwill play in determining tax treatment during business sales?

B. Suggested Answers to Discussion Questions

1. Why do buyers and sellers typically have adverse interests in structuring a business sale, and how can advisors mediate these differences?

Buyers and sellers approach transactions with competing objectives. Buyers want an asset sale to gain a stepped-up basis and maximize deductions, while sellers prefer stock sales for favorable capital gains treatment and to avoid recognizing ordinary income on certain assets. This natural tension creates negotiation challenges. Advisors bridge the gap by identifying trade-offs—perhaps offering a higher purchase price in exchange for an asset sale, or structuring earn-outs and installment plans to mitigate tax exposure. Tax-efficient reorganizations, such as those under Sections 351 or 368, can sometimes balance both sides' interests. Effective advisors evaluate both the tax and business implications, model after-tax outcomes, and clearly communicate the long-term value of each structure to help the parties reach a mutually beneficial agreement.

2. How does due diligence impact the success of business acquisitions?

Due diligence is the backbone of a successful acquisition. It allows buyers to confirm the target's value, identify risks, and verify ownership of critical assets, licenses, and contracts. For sellers, due diligence ensures readiness, minimizes post-sale disputes, and enhances credibility. Failure to conduct proper due diligence can expose buyers to hidden liabilities—such as tax liens, unassignable leases, or contingent debts—and leave sellers vulnerable to claims of misrepresentation. Beyond financial and legal verification, due diligence also assesses operational capacity and future profitability. A thorough process often dictates the structure of the deal, influencing whether the transaction proceeds as an asset or stock sale. In short, diligence protects all parties and transforms uncertainty into informed decision-making.

3. What role does goodwill play in determining tax treatment during business sales?

Goodwill represents the intangible value of a business beyond its tangible assets—often tied to reputation, customer relationships, and brand equity. For tax purposes, distinguishing between **corporate** and **personal** goodwill can yield dramatically different results. Corporate goodwill belongs to the entity and triggers corporate-level taxation, while personal goodwill is linked to the owner's personal reputation or expertise and is taxed as long-term capital gain at the individual level. Courts, as in *Martin Ice Cream Co.*, have upheld that absent employment or non-compete agreements, personal goodwill belongs to the individual, not the corporation. Properly identifying and documenting goodwill can significantly reduce tax liability and should be a key part of pre-sale planning and contract drafting.

GLOSSARY

Circular 230—A set of regulations governing practice before the IRS, outlining due diligence, competence, and ethical standards for tax professionals.

Cohan Rule—A judicial doctrine allowing taxpayers to claim reasonable estimates of expenses when records are incomplete, provided credible evidence supports the deduction.

Goodwill—The intangible value of a business based on reputation, customer loyalty, or brand recognition; may be personal or corporate for tax purposes.

Hobby Loss Rules (IRC §183)—Tax provisions limiting deductions for activities not engaged in for profit; income remains taxable, but expenses are generally nondeductible.

Hot Assets—Partnership assets such as unrealized receivables and inventory that generate ordinary income upon sale under Section 751.

Section 1060—The Internal Revenue Code provision requiring allocation of purchase price among asset classes in a business acquisition using the residual method.

Choose the best response and record your answer in the space provided on the answer sheet.

1. Which of the following best summarizes the Cohan Rule?
 - A. Taxpayers may claim any deduction they recall.
 - B. Deductions are only allowed with receipts.
 - C. Reasonable estimates may be used when actual records are unavailable.
 - D. IRS must accept all claimed deductions.

2. Which of the following expenses cannot be estimated under any circumstances?
 - A. Office supplies
 - B. Travel, meals, gifts, and listed property
 - C. Utilities
 - D. Depreciation

3. The hobby loss rules under Section 183 primarily determine whether:
 - A. An expense is deductible as ordinary or capital.
 - B. An activity is engaged in for profit.
 - C. A taxpayer qualifies for itemized deductions.
 - D. A loss may be carried forward.

4. What key element must be demonstrated to defend against a hobby loss challenge?
 - A. Demonstrating a genuine intent to make a profit.
 - B. A written business plan.
 - C. Three years of profitability.
 - D. Significant personal enjoyment.

5. Under Circular 230, due diligence applies when:
 - A. Representing clients in federal court.
 - B. Preparing or assisting in the preparation of tax returns.
 - C. Managing client investments.
 - D. Providing personal financial advice.

Continued on next page

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6. What was the key holding in Agarwal regarding real estate professionals?
- A. Only brokers can qualify.
 - B. Real estate agents may qualify if they meet the IRS tests.
 - C. Passive income automatically qualifies.
 - D. Material participation is not required.
7. Under the hobby loss rules of Section 183, when does the IRS presume that an activity is engaged in for profit?
- A. When the taxpayer maintains separate books and records for the activity.
 - B. When the activity shows a profit in at least three of the past five years.
 - C. When the taxpayer invests more than 750 hours annually in the activity.
 - D. When the activity involves assets that may appreciate in value.
8. In Harary, which specific misconduct led to disbarment?
- A. Bribing an IRS agent
 - B. Filing false returns
 - C. Misrepresenting information to his client
 - D. Failing to report income
9. Under Section 274(d), which item must be substantiated by records?
- A. Business gifts
 - B. Office rent
 - C. Advertising expenses
 - D. Payroll taxes
10. Which of the following is *not* among the nine IRS factors for determining a profit motive?
- A. Recordkeeping practices
 - B. Time and effort devoted
 - C. Personal enjoyment
 - D. Political affiliation

Continued on next page

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11. Which section governs the allocation of purchase price in an applicable asset acquisition?
- A. Section 754
 - B. Section 1060
 - C. Section 351
 - D. Section 751
12. What is the main advantage to a seller of structuring a business sale as a stock sale?
- A. Ability to claim ordinary losses
 - B. Recognition of capital gain and single-level taxation
 - C. Step-up in asset basis
 - D. Avoidance of Section 338 elections
13. The built-in gains tax in an S corporation applies to:
- A. Assets acquired after S election
 - B. All asset sales regardless of holding period
 - C. Assets held at the time of C-to-S conversion sold within 5 years
 - D. Shareholder dividends exceeding basis
14. In a sale involving goodwill, when is goodwill considered personal to the shareholder?
- A. When tied to the shareholder's professional reputation or relationships
 - B. When recorded on the corporate books
 - C. When the corporation holds the trade name
 - D. When a non-compete agreement exists
15. The election allowing adjustment of inside basis to match outside basis for a new partner is found under:
- A. Section 743(b)
 - B. Section 351
 - C. Section 338
 - D. Section 1244

SUBSCRIBER SURVEY

Evaluation Form

Please take a few minutes to complete this survey related to the **CeriFi CPE Network Tax Report** and with your final exam or group attendance sheet to CeriFi, LLC. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to grading-cpedge@cerifi.com.

How would you rate the topics covered in the December 2025 issue of **CeriFi CPE Network Tax Report**? Rate each topic on a scale of 1–5 (5=highest):

	Topic Relevance	Topic Content/ Coverage	Topic Timeliness	Video Quality	Audio Quality	Written Material
Segment 1	_ _ _	_ _ _	_ _ _	_ _ _	_ _ _	_ _ _
Segment 2	_ _ _	_ _ _	_ _ _	_ _ _	_ _ _	_ _ _

Which segment of this issue of **CeriFi CPE Network Tax Report** did you like the most, and why?

Which segment of this issue of **CeriFi CPE Network Tax Report** did you like the least, and why?

What would you like to see included or changed in future issues of **CeriFi CPE Network Tax Report**?

Are there any other ways in which we can improve **CeriFi CPE Network Tax Report**?

How would you rate the effectiveness of the speakers in this issue of **CeriFi CPE Network Tax Report**? Rate each speaker on a scale of 1–5 (5 highest):

	Overall	Knowledge of Topic	Presentation Skills
Mike Giangrande	_____	_____	_____
Ian J. Redpath	_____	_____	_____

Are you using **CeriFi CPE Network Tax Report** for: CPE Credit Information Both

Were the stated learning objectives met? Yes No _____

If applicable, were prerequisite requirements appropriate? Yes No _____

Were program materials accurate? Yes No _____

Were program materials relevant and contribute to the achievement of the learning objectives? Yes No _____

Were the time allocations for the program appropriate? Yes No _____

Were the supplemental reading materials satisfactory? Yes No _____

Were the discussion questions and answers satisfactory? Yes No _____

Specific Comments:

Name/Company _____

Address _____

City/State/Zip _____

Email _____

**Once Again, Thank You...
Your Input Can Have a Direct Influence on Future Issues!**

CERIFI CPE NETWORK USER GUIDE

REVISED August 2025

Welcome to CeriFi CPE Network!

CeriFi CPE Network programs enable you to deliver training programs to those in your firm in a manageable way. You can choose how you want to deliver the training in a way that suits your firm's needs: in the classroom, virtual, or self-study. You must review and understand the requirements of each of these delivery methods before conducting your training to ensure you meet (and document) all the requirements.

This User Guide has the following sections:

- **“Group Live” Format:** The instructor and all the participants are gathered into a common area, such as a conference room or training room at a location of your choice.
- **“Group Internet Based” Format:** Deliver your training over the internet via Zoom, Teams, Webex, or other application that allows the instructor to present materials that all the participants can view at the same time.
- **“Self-Study” Format:** Each participant can take the self-study version of the CeriFi CPE Network program on their own computers at a time and place of their convenience. No instructor is required for self-study.
- **What Does It Mean to Be a CPE Sponsor?:** Should you decide to vary from any of the requirements in the 3 methods noted above (for example, provide less than 3 full CPE credits, alter subject areas, offer hybrid or variations to the methods described above), CeriFi CPE Network will not be the sponsor and will not issue certificates. In this scenario, your firm will become the sponsor and must issue its own certificates of completion. This section outlines the sponsor's responsibilities that you must adhere to if you choose not to follow the requirements for the delivery methods.
- **Getting Help:** Refer to this section to get your questions answered.

IMPORTANT: This User Guide outlines in detail what is required for the formats above. Additionally, because you will be delivering the training within your firm, you should review the Sponsor Responsibilities section as well. To get certificates of completion for your participants following your training, you must submit all the required documentation. (This is noted at the end of each section.) CeriFi CPE Network will review your training documentation for completeness and adherence to all requirements. If all your materials are received and complete, certificates of completion will be issued for the participants attending your training. Failure to submit the required completed documentation will result in delays and/or denial of certificates.

IMPORTANT: If you vary from the instructions noted above, your firm will become the sponsor of the training event and you will have to create your own certificates of completions for your participants. In this case, you do not need to submit any documentation back to CeriFi, LLC.

If you have any questions on this documentation or requirements, refer to the “Getting Help” section at the end of this User Guide **BEFORE** you conduct your training.

We are happy that you chose CeriFi CPE Network for your training solutions.

Thank you for your business and HAPPY LEARNING!

Copyrighted Materials

CeriFi CPE Network program materials are copyrighted and may not be reproduced in another document or manuscript in any form without the permission of the publisher. As a subscriber of the **CeriFi CPE Network Series**, you may reproduce the necessary number of participant manuals needed to conduct your group study session.

“Group Live” Format

CPE Credit

All CeriFi CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** CeriFi CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by CeriFi CPE Network. CeriFi CPE Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as CeriFi CPE Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template after the executive summary of the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance

You must monitor individual participant attendance at “group live” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **attendance sheet**. This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a “no show,” the actual hours they attended should be documented on the sign-in sheet and will be reflected on the participant’s CPE certificate.

Real Time Instructor During Program Presentation

“Group live” programs must have a **qualified, real time instructor while the program is being presented**. Program participants must be able to interact with the instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A “group live” program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Make-Up Sessions

Individuals who are unable to attend the group study session may use the program materials for self-study online.

- If the emailed materials are used, the user should read the materials, watch the video, and answer the final exam questions on the CPE Answer Sheet. Send the answer sheet and course evaluation to the email address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual CeriFi account to read the materials, watch the interviews, and answer the final exam questions. The user will be able to print her/his/their CPE certificate upon completion of the final exam. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded by CeriFi CPE Network after the “group live” documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the “group live” session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to CeriFi CPE Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether CeriFi CPE Network is the sponsor for the “group live” session, it is required that the firm hosting the “group live” session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Group Study Attendance sheets; indicating any late arrivals and/or early departures)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations.

Finding the Transcript

The entire transcript is available as a pdf via the link in the email sent to administrators.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your “group live” session should be sent to CeriFi CPE Network by the following means:

Email: grading-cpedge@cerifi.com

When sending your package to CeriFi, you must include ALL of the following items:

Form Name	Included?	Notes
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Attendance Sheet		Use this form to track attendance during your training session.
Subscriber Survey Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to CeriFi any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

“Group Internet Based” Format

CPE Credit

All CeriFi CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** CeriFi CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by CeriFi CPE Network. CeriFi CPE Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures. Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as CeriFi CPE Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template following the executive summary in the transcript. You should circulate (e.g., email to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance in a Webinar

You must monitor individual participant attendance at “group internet based” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **Webinar Delivery Tracking Report**. This form lists the moderator(s) name and credentials, as well as the first and last name of each participant attending the seminar. During a webinar you must set up a monitoring mechanism (or polling mechanism to periodically check the participants’ engagement throughout the delivery of the program. Participants’ two-way video should remain on during the entire presentation.

In order for CPE credit to be granted, you must confirm the presence of each participant **3 times per CPE hour and the participant must reply to the polling question**. Participants that respond to less than 3 polling questions in a CPE hour will not be granted CPE credit. For example, if a participant only replies to 2 of the 3 polling questions in the first CPE hour, credit for the first CPE hour will not be granted. (Refer to the Webinar Delivery Tracking Report for examples.)

Examples of polling questions:

1. You are using **Zoom** for your webinar. The moderator pauses approximately every 15 minutes and asks that participants confirm their attendance by using the “raise hands” feature. Once the participants raise their hands, the moderator records the participants who have their hands up in the **webinar delivery tracking report** by putting a YES in the webinar delivery tracking report. After documenting in the spreadsheet, the instructor (or moderator) drops everyone’s hands and continues the training.
2. You are using **Teams** for your webinar. The moderator will pause approximately every 15 minutes and ask that participants confirm their attendance by typing “Present” into the Teams chat box. The moderator records the participants who have entered “Present” into the chat box into the **webinar delivery tracking report**. After documenting in the spreadsheet, the instructor (or moderator) continues the training.
3. If you are using an application that has a way to automatically send out polling questions to the participants, you can use that application/mechanism. However, following the event, you should create a **webinar delivery tracking report** from your app’s report.

Additional Notes on Monitoring Mechanisms:

1. The monitoring mechanism does not have to be “content specific.” Rather, the intention is to ensure that the remote participants are present and paying attention to the training.
2. You should only give a minute or so for each participant to reply to the prompt. If, after a minute, a participant does not reply to the prompt, you should put a NO in the webinar delivery tracking report.
3. While this process may seem unwieldy at first, it is a required element that sponsors must adhere to. And after some practice, it should not cause any significant disruption to the training session.
4. **You must include the Webinar Delivery Tracking report with your course submission if you are requesting certificates of completion for a “group internet based” delivery format.**

Real Time Moderator During Program Presentation

“Group internet based” programs must have a **qualified, real time moderator while the program is being presented**. Program participants must be able to interact with the moderator while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

Where individual participants log into a group live program they are required to enable two-way video to participate in a virtual face-to-face setting (with cameras on), elements of engagement are required (such as group discussion, polling questions, instructor posed questions with time for reflection, or a case study with engagement throughout the presentation) in order to award CPE credits to the participants. Participation in the two-way video conference must be monitored and documented by the instructor or attendance monitor in order to authenticate attendance for program duration. The participant-to-attendance monitor ratio must not exceed 25:1, unless there is a dedicated attendance monitor in which case the participant-to-attendance monitor ratio must not exceed 100:1.

Make-Up Sessions

Individuals who are unable to attend the “group internet based” session may use the program materials for self-study either in print or online.

- If emailed materials are used, the user should read the materials, watch the video, and answer the final exam questions on the CPE Answer Sheet. Send the answer sheet and course evaluation to the email address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual CeriFi CPE account to read the materials, watch the interviews, and answer the final exam questions. The user will be able to print her/his CPE certificate upon completion of the final exam. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded by CeriFi CPE Network after the “group internet based” documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who may not have answered the required amount of polling questions.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the “group live” session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to CeriFi CPE Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether CeriFi CPE Network is the sponsor for the “group internet based” session, it is required that the firm hosting the session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Webinar Delivery Tracking Report)
- Copy of the program materials
- Timed agenda with topics covered
- Date and location (which would be “virtual”) of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations

Finding the Transcript

The email sent to administrators each month has a link to the pdf for the newsletter. The email may be forwarded to participants who may download the materials or print them as needed.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your “group internet based” session should be sent to CeriFi CPE Network by the following means:

Email: grading-cpedge@cerifi.com

When sending your package to CeriFi, you must include ALL the following items:

Advertising /		Complete this form and circulate to your audience
Webinar Delivery		Use this form to track the attendance (i.e., polling
Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to CeriFi any evaluations that were completed. You do not have to

Incomplete submissions will be returned to you.

“Self-Study” Format

If you are unable to attend the live group study session, we offer two options for you to complete your Network Report program.

Self-Study—Email

Follow these simple steps to use the printed transcript and video:

- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the final exam by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
- E-mail your completed final exam and survey to:

grading-cpedge@cerifi.com

Self-Study—Online

Follow these simple steps to use the online program:

- Go to <https://cerificpedge.com/>.
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).

The screenshot shows the CeriFi CPEdge website. At the top, there is a navigation bar with the CeriFi CPEdge logo on the left, and links for "Contact Us", a shopping cart icon, and a "Login" button on the right. Below the navigation bar is a search bar with the placeholder text "Search courses". A blue banner below the search bar reads "Checkpoint Learning is now CeriFi CPEdge!". The main content area features the heading "CeriFi CPEdge CPE for CPAs" and a sub-heading "The highest quality continuing professional education for CPAs and EAs looking to grow their knowledge in tax, accounting, finance, and more." To the right of this text is a photograph of a woman wearing glasses and talking on a mobile phone. Below the main heading, there are three columns of content: "Achieve your goals, your way." with sub-sections "Stay up to date", "Grow your expertise", "Learn the way you like", and "Upskill your organization"; "Formats for every learning style and schedule." with sub-sections "Live events" (Webinars and Virtual Conferences, Seminars, Conferences) and "On-demand courses" (Self Study and Online Grading, Nano Courses, Video Learning, On-Demand Webinars).

- In the **Cerifi CPE Network** tab, select the desired Network Report and then the appropriate edition.

The screenshot shows the Cerifi CPEEdge website interface. At the top is a navigation bar with links: Homeeroom, Search Courses, CPE Network, Status Reports, Activity History, Learning (with a dropdown arrow), and Resources. Below the navigation bar is the 'CPE Network' section. On the left is a 'CPE Network Menu' with a 'Network' link and three report categories: NETWORK TAX REPORT, NETWORK ACCOUNTING AND AUDITING REPORT, and GOVERNMENTAL NONPROFIT ACCOUNTING REPORT. To the right is a table with the following data:

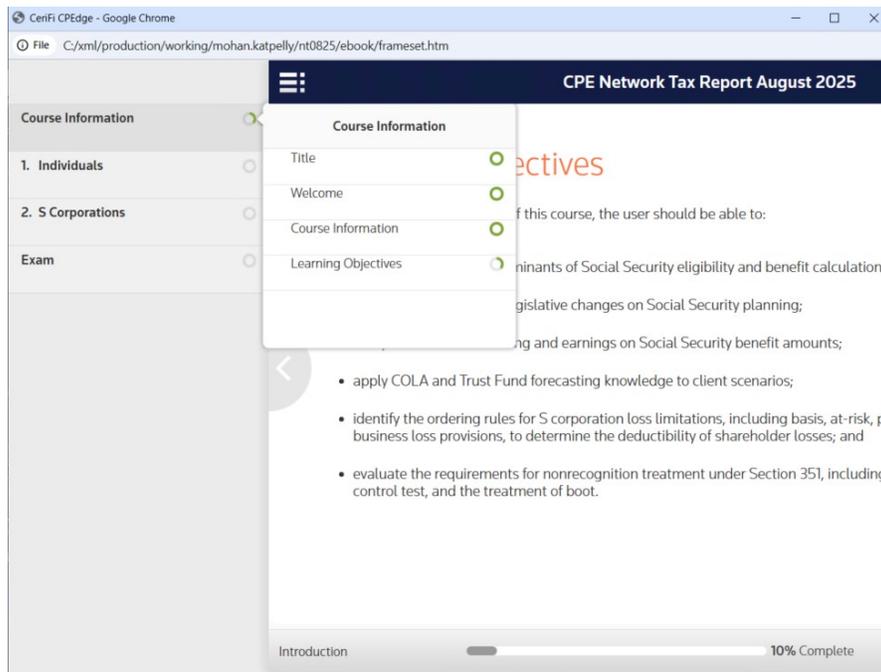
CPE Network	Subscription Expiration Date	Latest Issue Available
NETWORK TAX REPORT	11/5/2118	July 2025
NETWORK ACCOUNTING AND AUDITING REPORT	11/5/2118	July 2025
GOVERNMENTAL NONPROFIT ACCOUNTING REPORT	9/19/2027	July 2025

The Chapter Menu is in the gray bar at the left of your screen:

The screenshot shows a course page in a browser window titled 'Cerifi CPEEdge - Google Chrome'. The page title is 'CPE Network Tax Report August 2025'. On the left is a gray chapter menu with the following items: Course Information (with a green checkmark), 1. Individuals, 2. S Corporations, and Exam. The main content area is titled 'Learning Objectives' and contains the following text: 'Upon successful completion of this course, the user should be able to:' followed by a bulleted list of six objectives. At the bottom of the page, there is a progress bar showing 'Introduction' and '10% Complete'.

Click down to access the dropdown menu and move between the program Chapters.

- **Course Information** is the course Overview, including information about the authors and the program learning objectives



- **Each Chapter is self-contained.** Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the self-study questions. This streamlined approach allows administrators and users to more easily access the related materials.



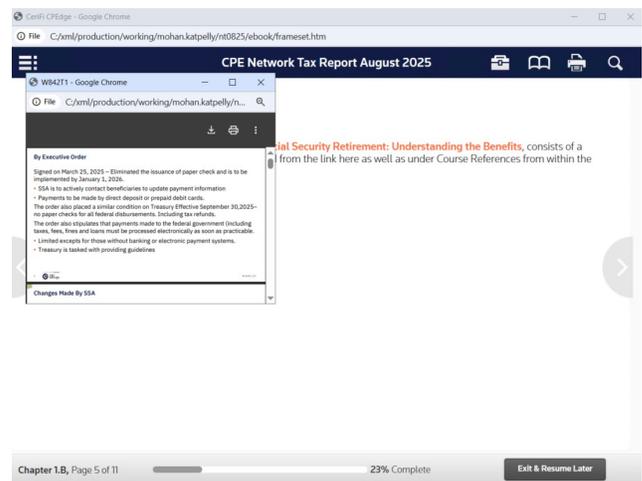
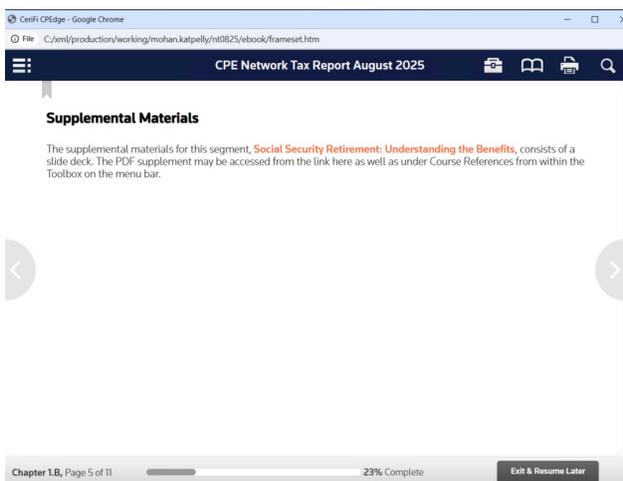
Video segments may be downloaded from the player by clicking on the download button. *Tip: you may need to scroll down to see the download button.*

Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts**

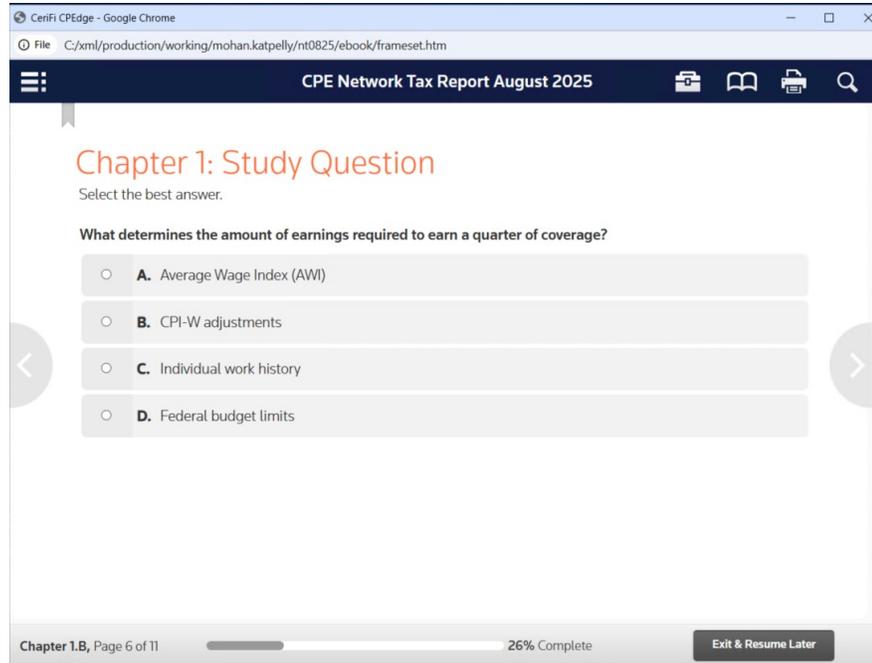
Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material.



The supplemental materials are available via the toolbox and the link will pop up the pdf version in a separate window.



Continuing to click the arrow to the right side of the screen will bring the user to the self-study questions related to the segment.

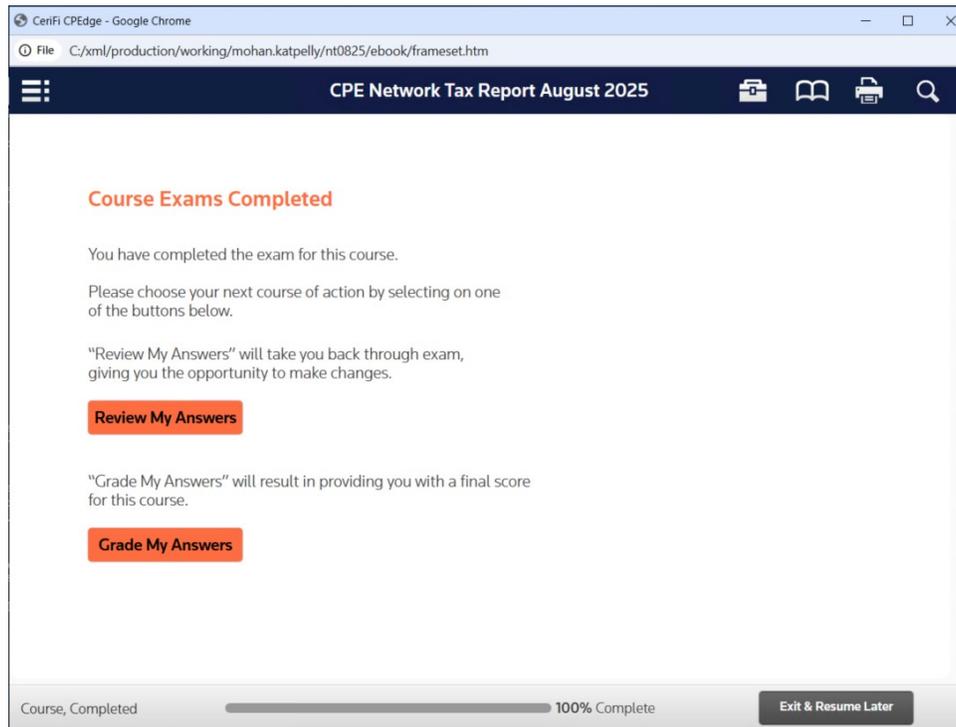


The screenshot shows a web browser window with the following elements:

- Browser Title Bar:** Cerifi CPEdge - Google Chrome
- Address Bar:** File C:/xml/production/working/mohan.katpelly/nt0825/ebook/frameset.htm
- Page Header:** CPE Network Tax Report August 2025
- Section Header:** Chapter 1: Study Question
- Instruction:** Select the best answer.
- Question:** What determines the amount of earnings required to earn a quarter of coverage?
- Options:**
 - A. Average Wage Index (AWI)
 - B. CPI-W adjustments
 - C. Individual work history
 - D. Federal budget limits
- Navigation:** Left and right arrows on the sides of the question area.
- Footer:** Chapter 1.B, Page 6 of 11 | 26% Complete | Exit & Resume Later

The **Exam** is accessed by clicking the last gray bar on the menu at the left of the screen or clicking through to it. Click the orange button to begin.

When you have completed the final exam, click the button labeled **Grade or the Review button**.



- Click the button labeled **Certificate** to print your CPE certificate.
- The final exam grade is displayed and you may view the graded answers by clicking the button labeled **view graded answer**.

Additional Features Search

CeriFi CPE offers powerful search options. Click the **magnifying glass** at the upper right of the screen to begin your search. Enter your choice in the **Search For:** box.

Search Results are displayed with the number of hits.

Print

To display the print menu, click the printer icon in the upper bar of your screen. You can print the entire course, the transcript, the glossary, all resources, or selected portions of the course. Click your choice and click the orange **Print**.

What Does It Mean to Be a CPE Sponsor?

If your organization chooses to vary from the instructions outlined in this User Guide, your firm will become the CPE Sponsor for this monthly series. The sponsor rules and requirements noted below are only highlights and reflect those of NASBA, the national body that sets guidance for development, presentation, and documentation for CPE programs. **For any specific questions about state sponsor requirements, please contact your state board. They are the final authority regarding CPE Sponsor requirements.** Generally, the following responsibilities are required of the sponsor:

- Arrange for a location for the presentation
- Advertise the course to your anticipated participants and disclose significant features of the program in advance
- Set the start time
- Establish participant sign-in procedures
- Coordinate audio-visual requirements with the facilitator
- Arrange appropriate breaks
- Have a real-time instructor during program presentation
- Ensure that the instructor delivers and documents elements of engagement
- Monitor participant attendance (make notations of late arrivals, early departures, and “no shows”)
- Solicit course evaluations from participants
- Award CPE credit and issue certificates of completion
- Retain records for five years

The following information includes instructions and generic forms to assist you in fulfilling your responsibilities as program sponsor.

CPE Sponsor Requirements

Determining CPE Credit Increments

Sponsored seminars are measured by program length, with one 50-minute period equal to one CPE credit. One-half CPE credit increments (equal to 25 minutes) are permitted after the first credit has been earned. Sponsors must monitor the program length and the participants' attendance in order to award the appropriate number of CPE credits.

Program Presentation

CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. CPE program sponsors must make the following information available in advance:

- Learning objectives.
- Instructional delivery methods.
- Recommended CPE credit and recommended field of study.
- Prerequisites.
- Program level.
- Advance preparation.
- Program description.
- Course registration and, where applicable, attendance requirements.
- Refund policy for courses sold for a fee/cancellation policy.
- Complaint resolution policy.
- Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPE credits).

Disclose Significant Features of Program in Advance

For potential participants to effectively plan their CPE, the program sponsor must disclose the significant features of the program in advance (e.g., through the use of brochures, website, electronic notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with non-educational activities, or when several CPE programs are offered concurrently, participants must receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration and attendance policies and procedures must be formalized, published, and made available to participants and include refund/cancellation policies as well as complaint resolution policies.

Monitor Attendance

While it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must maintain a process to monitor individual attendance at group programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient. The sign-in sheet should list the names of each instructor and her/his credentials, as well as the name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant leaves early, the hours they attended should be documented on the sign-in sheet and on the participant's CPE certificate.

Real Time Instructor During Program Presentation

“Group live” programs must have a qualified, real-time instructor while the program is being presented. Program participants must be able to interact with the real time instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A “group live” program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded at the conclusion of the seminar. It should reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

CFP credit is available if the firm registers with the CFP board as a sponsor and meets the CFP board requirements. IRS credit is available only if the firm registers with the IRS as a sponsor and satisfies their requirements.

Seminar Quality Evaluations for Firm Sponsor

NASBA requires the seminar to include a means for evaluating quality. At the seminar conclusion, evaluations should be solicited from participants and retained by the sponsor for five years. The following statements are required on the evaluation and are used to determine whether:

1. Stated learning objectives were met.
2. Prerequisite requirements were appropriate (if any).
3. Program materials were accurate.
4. Program materials were relevant and contributed to the achievement of the learning objectives.
5. Time allotted to the learning activity was appropriate.
6. Individual instructors were effective.
7. Facilities and/or technological equipment were appropriate.
8. Handout or advance preparation materials were satisfactory.
9. Audio and video materials were effective.

You may use the enclosed preprinted evaluation forms for your convenience.

Retention of Records

The seminar sponsor is required to retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (the original sign-in sheets, now in an editable, electronic signable format)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name(s) and credentials
- Results of program evaluations

Appendix: Forms

Here are the forms noted above and how to get access to them.

Delivery Method	Form Name	Location	Notes
"Group Live" / "Group Internet Based"	Advertising / Promotional Page	Transcript	Complete this form and circulate to your audience before the training event.
"Group Live"	Attendance Sheet	Transcript	Use this form to track attendance during your training session.
"Group Internet Based"	Webinar Delivery Tracking Report	Transcript	Use this form to track the 'polling questions' which are required to monitor attendance during your webinar.
"Group Live" / "Group Internet Based"	Evaluation Form	Transcript	Circulate the evaluation form at the end of your training session so that participants can review and comment on the training.
Self Study	CPE Answer Sheet	Transcript	Use this form to record your answers to the final exam.

Getting Help

Should you need support or assistance with your account, please see below:

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	844.245.5970	cpedgesupport@cerifi.com	<ul style="list-style-type: none">• Browser-based• Certificate discrepancies• Accessing courses• Migration questions• Feed issues
Product Support	844.245.5970	cpedgesupport@cerifi.com	<ul style="list-style-type: none">• Functionality (how to use, where to find)• Content questions• Login Assistance
Customer Support	844.245.5970	cpedgesupport@cerifi.com	<ul style="list-style-type: none">• Billing• Existing orders• Cancellations• Webinars• Certificates