NINJA CPA Review®

NINJA Notes

Regulation 2020

2020 REG

Source: AICPA

Content Area		Allocation
Area I	Ethics, Professional Responsibilities and Federal Tax Procedures	10–20%
Area II	Business Law	10–20%
Area III	Federal Taxation of Property Transactions	12–22%
Area IV	Federal Taxation of Individuals	15–25%
Area V	Federal Taxation of Entities	28–38%

Skill Levels	
Evaluation	The examination or assessment of problems, and use of judgment to draw conclusions.
Analysis	The examination and study of the interrelationships of separate areas in order to identify causes and find evidence to support inferences.
Application	The use or demonstration of knowledge, concepts or techniques.
Remembering and Understanding	The perception and comprehension of the significance of an area utilizing knowledge gained.

Table of Contents

The N.I.N.J.A. Framework

Taxations

Law & Professional Responsibilities

Please Note: 2019 Tax Law is tested until July 2020.

How to use NINJA Notes

Reading

You've invested in NINJA Monthly, now let the NINJA Notes go to battle for you. You should read them as many times as possible.

Carry it with you wherever you go.

Simply load the PDF onto your mobile device, and **if you have 5 minutes of downtime, you have 5 minutes of study time.**

It is recommended that you read the NINJA Notes at least **five times** leading up to your final two weeks of exam prep.

If you have 6 weeks to study, then you need to complete this in 4 weeks. 5 weeks to study, then complete it in 3.4 weeks = 2 weeks. You get the picture. The point is: plan, plan, plan and budget, budget, budget, budget because exam day is looming.

Learning Plans	
6-Week Plan	• Approx. 122 pages x 5 reads • 4 weeks • 7 days per week = Approx. 22 pages per day
5-Week Plan	• Approx. 122 pages x 5 reads • 3 weeks • 7 days per week = Approx. 29 pages per day
4-Week Plan	• Approx. 122 pages x 5 reads • 2 weeks • 7 days per week = Approx. 43 pages per day
3-Week Plan	• Approx. 122 pages x 5 reads • 1 week • 7 days per week = Approx. 87 pages per day

Re-Writing The NINJA Notes

This step is optional, but it won over a lot of skeptics with its results. This is not mainstream advice. This is the NINJA way. The mainstream way of studying for the CPA Exam is old-fashion and outdated.

Forget the old way. **You are a NINJA now**.

Now is the time to either:

1. Re-write your own CPA Exam notes or
2. Re-Write the NINJA Notes.

Plan on investing a week doing this, and you should expect to get through at least 20 pages a day to stay on track.

I. Individual Taxation

2019 Individual Tax Rates

Single Taxpayer (Don't Memorize)

Tax Rate	Taxable Income Over	But Not Over
10%	$0	$9,700
12%	$9,701	$39,475
22%	$39,476	$84,200
24%	$84,201	$160,725
32%	$160,726	$204,100
35%	$204,101	$510,300
37%	$510,300+	

Married Filing Jointly (Don't Memorize)

Tax Rate	Taxable Income Over	But Not Over
10%	$0	$19,400
12%	$19,401	$78,950
22%	$78,951	$168,400
24%	$168,401	$321,450
32%	$321,451	$408,200
35%	$408,201	$612,350
37%	$612,350+	

Overview Of Form 1040

	Gross Income
	<Adjustments>
=	**Adjusted Gross Income (AGI)**
	<Standard Deduction>
	or
	<Itemized Deductions>
=	**TI Before Qualified Business Income Deduction**
	<Qualified Business Income Deduction>
=	**Taxable Income**
x	Tax Rate
=	**Federal Income Tax**
	< Tax Credits >
	Alternative Minimum Tax
	Self-Employment Tax
	< Payments >
=	**Tax Due**

Filing Status

- Single
- Married Filing Jointly
- Married Filing Separately
- Qualifying Widower
- Head of Household

Cash Basis Accounting

- Allowed for
    - Businesses with < $25MM Revenue (3 Year Avg)
        - TCJA Now Allows Cash Basis for
            - Corporations
            - Partnerships with C-Corp Partner
            - Businesses with Inventory
        - $25MM Rule still applies

Inclusions In Gross Income

- Wages & Salaries
    - Wages & Tips
    - Cancellation of Debt
    - Bargain Purchase
    - Guaranteed Payments
    - Life Insurance Premiums (above $50k coverage)
    - Taxable fringe benefits and Stock options.
- Interest & Dividends
    - Taxable Interest and Dividends
        - Interest on Federal Bonds
        - Treasury Bills
        - Interest on late payment of tax refunds

        - All dividends unless specifically excluded
    - Non-Taxable Interest and Dividend
        - State, Municipal and US Possession Bond Interest
        - Series EE and I savings bond
        - Non-taxable return of Capital
        - Stock Splits and Stock Dividends
        - S-Corp Dividends
- Business Income or Loss

Gross Receipts

<Returns & Allowances>

Net Receipts

<COGS>

Gross Profit

\+ Other Income

Gross Income

<Total Expenses>

= **Net Profit (Loss)**

    - Expenses Include:
        - Salaries & Wages
        - Taxes
        - Office Expense
        - Business use of home

        - Transportation Expenses
        - Business Meals (50% deductible)
            - Note: Entertainment not deductible
        - Business Travel (100% deductible)
        - Interest on Business Loans
        - Legal & Professional services & fees
        - Business Bad Debt
        - Depreciation & Amortization

Business Start-up Costs

- Deduct up to $5,000 of Start-up costs
- Reduced dollar-for-dollar by amount over $50,000
- Remaining costs are amortized

Capital Gains & Losses

Amount Realized
<Adjusted Basis of Assets Sold>

Capital Gain or Loss Realized

- Short-term Capital Gains & Losses
    - Holding period is 1 year or less
    - Treat as ordinary income and tax at ordinary rates

- Long-term Capital Gains & Losses
    - Holding period is 1 year or more
    - Tax Rates
        - 0% - Low income taxpayers
        - 15% - Most taxpayers
        - 20% - Certain high-income taxpayers
- Capital Loss (Individual)
    - $3,000 Loss and Carry Forward rest Indefinitely
    - Loss retains Character (STCL vs LTCL)
        - Compare to a Corporation
            - 3 years back /5 years forward
            - Corp Carry Forward as an STCL only

Passive Income

- Rental real estate
- Royalties
- Income from Schedule K-1
    - Partnerships and Limited Liability Companies
    - S Corporations
    - Estates & Trusts
    - Closely-Held & Personal Service C Corps

Farm Income

Income Items	Expense Items
• Produce, grains and livestock held for sale • Livestock bought for resale	• Do not include personal or living expenses • Include reasonable wages to children, meals to feed workers • Depreciation

Other Items Of Inclusion In Gross Income

- Alimony Received
    - Divorce Prior to December 31, 2018
        - Taxable
    - Divorce After December 31, 2018
        - Not Taxable
- Social Security Benefits
    - Up to 85%
- IRA Withdrawals
- State and Local Tax Refund
    - If Itemized
- Unemployment Compensation
- Pensions and Annuities

Other Items Of Exclusion From Gross Income

- Foreign-Earned Income
- Inheritance & Gifts
- Life Insurance Proceeds
- Workman's Compensation
- Injury Awards

Deductions To Arrive At Agi

- MSA/HSA Contributions
- Educator Expenses: Up to $250 of qualified expenses.
- Deductible part of Self-Employment Tax
- Self-Employed SEP, SIMPLE, and Qualified Plans
- Self-Employed Health Insurance Premiums
- Investment penalties for early withdrawal
- Alimony Paid
    - Divorce Prior to December 31, 2018
        - Deductible
    - Divorce After December 31, 2018
        - Not Deductible
- IRA Deduction
- Student Loan Interest up to $2,500

    - Can't be another taxpayer's dependent
- Qualified Tuition and Fees
    - Note: This benefit is related to the taxpayer's tax rate (it reduces the amount (AGI) to which the tax rate is applied)
    - The American Opportunity Credit is a dollar for dollar credit and more advantageous

Deductions & Exemptions

- 2019 Standard Deduction
    - MFJ - $24,400
    - Single - $12,200
    - Head of Household - $18,350
- 2019 Personal Exemption
    - Repealed under TCJA

Itemized Deductions – Schedule A

- Medical Expenses – Schedule A
    - Deductible once 10% AGI threshold is reached
    - If your AGI is $100,000, your first $10,000 of medical expenses are not deductible
    - Accident/Disability insurance is not deductible
- Medical Expense - Paid On Behalf Of Another

    - Must be a Citizen of North America
    - If person is your mother/father or relative closer than a cousin, they don't have to live with you
    - Otherwise, they must live with you
    - Must provide more than 50% support to individual
- State, Property, & Local Taxes (SALT)
    - Deduction Limited to $10,000
    - Choose One of the Following:
        - Property Tax + State & Local Income Taxes
        - Property Tax + State & Local Sales Taxes
- Foreign Taxes Paid
    - Foreign Income Tax - Deductible
    - Foreign Real Estate Tax - Not Deductible
        - Prior to TCJA, this was Deductible
    - Foreign Personal Property Taxes - Not Deductible
    - Foreign Tax Assessments - Not Deductible
        - Add to Basis
- Investment Interest Expense
    - Deductible to extent of Net Investment Income

Mortgage Interest Expense

- Mortgage Interest & Home Equity Loan Interest
    - Post-December 16, 2017 Acquisition
        - Deductible if used to purchase, build, or substantially improve a house (i.e. not to pay off credit cards) on debt up to **$750,000**
    - Pre-December 16, 2017 Acquisition
        - Grandfathered under TCJA
        - Deductible if used to purchase, build, or substantially improve a house (i.e. not to pay off credit cards) on debt up to $1MM

Charitable Contributions

- Cash/Check
    - Up to 60% of AGI
- Property
    - Deduction for Lesser of FMV or Adjusted Basis
    - Up to 30% of AGI

Casualty Losses

- **Federal Disaster Areas Only** (New under TCJA)
- Applicable to property held for personal use with value drop in less than 30 days

- Decrease in FMV of property vs. Basis

Drop in FMV (limited to tax basis of the asset)
<Insurance/Government Reimbursement>
<$100 per event>

Loss Eligible for Deduction
<10% of AGI>

Deductible Casualty Loss

Qualified Business Income Deduction (Qbid)

- This deduction is for taxpayers who receive net income from certain rental activities, sole-proprietorships, and pass-through entities
- The QBID is the lesser of
    - QBID before Income Limitation or
    - Your Calculated Income Limitation
    - Calculated Income Limitation:

Taxable Income before QBID
<Net Capital Gains*>

$$$
x 20%

= **Calculated Income Limitation**

* (losses do not get deducted in this calculation)

- You are allowed a deduction of up to
    - 20% of your Net Qualified Business Income (**QBI**)
    - 20% of Net Qualified Real Estate Investment Trust (**REIT**) Dividends
    - 20% of Net Qualified Publicly Traded Partnership Income (**PTP**)
- If QBI from at least one trade or business is negative, the negative QBI is allocated in proportion to relative amounts of positive QBI to all other trades or business (aggregation rules apply)
- If the net QBI is a **loss** it is a carryforward to the next year for QBI, REIT, and PTP. The net loss is then treated as a negative QBI listed separately and applied to the succeeding taxable years QBI
    - This carryover rule does not affect the deductibility of the loss for purposes of other provisions

Note: This starts getting into details that are probably beyond the scope of the CPA Exam, but we include it (remaining QBI information below) since it's a new topic

- The phase-out range for taxpayers are:
    - Single, Trust, or Estate: $157,000 – $207,500
    - MFJ: $315,000 - $415,000
- For taxpayers within the phase-out range:
    - For each trade or business [including trades or business operated through relevant passthrough entities (RPE)] the individual must determine the lesser of:
        - 20% of the QBI for that trade or business, or
        - The greater of-

        - 50% of W-2 wages with respect to that trade or business, or
        - The sum of 25% of W-2 wages with respect to that trade or business plus 2.5% of the UBIA of a qualified property with respect to that trade or business
    - This will be the QBID for that specific trade or business
- Specified Service Trades or Businesses (SSTB) are generally excluded from the definition of a qualified trade or business for the section 199A deduction:
    - Exceptions Include:
        - If your taxable income is less than $157,000 for single ($315,000 MFJ) your specified service trade or business is treated as a qualified trade or business
        - If your taxable income is between $157,000 and $207,500 for single ($315,000 and $415,000 MFJ) an applicable percentage of your specified service trade or business is treated as a qualified business or trade
        - If your taxable income is over $207,500 for single ($415,000 MFJ) then no deduction is received from the trade or business that is classified as an SSTB

Tax Credits

- Tax Credits are classified under following two broad categories:
- Refundable Tax Credits
    - Taxpayer receives larger refund than money paid
        - Earned Income Credit

        - Child Tax Credit
            - $2,000 per child
                - $1,400 max refundable amount
        - American Opportunity Credit
- Personal Tax Credits
    - Tax liability reduction doesn't drop below zero
        - Foreign Tax Credit
        - General Business Credit
        - Adoption Credit
            - Expenses incurred in adopting a child who is less than 18 years of age.
        - $500 Dependent Credit (New under TCJA)
            - For Dependents who don't qualify for Child Tax Credit
                - Age 17-23 Student Child
                - Relative closer than a cousin, etc.

Education Credits

- Statement from School Required (Form 1098-T)
- American Opportunity Credit (formerly Hope Credit)
    - Includes first **4 years** of post-secondary school
        - Hope Credit only allowed first 2 years
    - 100% Credit for first $2,000 expenses including

            - Tuition
            - Course-related Books & Supplies
                - Hope Credit didn't include this
        - 25% Credit for next $2,000 of expenses
            - aka – up to $500
        - Total Available Credit per student: $2,500
            - vs Lifetime Learning Credit (per taxpayer)
        - 40% ($1,000) of credit is refundable
            - vs Lifetime Learning Credit (not refundable)
- Lifetime Learning Credit
    - Per taxpayer
    - Not refundable

Dependent & Child Care Credit

- Requires care for a Dependent child (under 13 years) or Disabled Dependent
- Credit is 20% - 35% of the least of:
    - Actual Expenses
        - Babysitter, Day Care, Etc.
    - Earned Income Limit
        - If MFJ use income of lower-paid spouse
    - $3,000 (one dependent)
    - $6,000 (multiple dependents)

Earned Income Credit

- For taxpayers with low-to-moderate earned income
- Established to offset burden of Social Security taxes

Foreign Tax Credit

- Can either be taken as an itemized deduction or used as income tax credit.

Alternative Minimum Tax (Amt)

- Difference between Depreciation on Real Estate purchases pre-'99 vs AMT's Straight Line 40
- Difference between 200% MACRS vs 150% MACRS on personal property
- Difference between FMV of stock options vs amount paid for them
- No state income tax, real estate tax, or personal property tax allowed for AMT.
- No standard deductions
- No installment method on sales allowed
- AMT paid is carried forward indefinitely and only reduces future regular tax, not future AMT

Self-Employment Tax

- 15.3% of Net Profit
- Exam Trick: Executor of Estate not SE Income

Kiddie Tax

	Child's Unearned Income
Deduction 1:	<$1,100>
Deduction 2*:	<$1,100 or Earned Income + $350>
	= Net Unearned Minor Income**

* Taxed at Child's Tax Rate

**Taxed at Trust & Estate Rates

Estimated Tax Payments (Individual)

- The lesser of:
    - 90% of current total tax
    - 100% of prior year's total tax
    - 110% of prior year's total tax
        - If AGI is $150,000 or more

Irs Audit Appeals

- If no deal is reached after Appeal
    - Taxpayer has 90 days to Petition the Tax Court
    - If no Petition filed – Tax due within 10 Days

Statute Of Limitations For A Tax Audit

- 3 years
- 6 years if 25% or more of gross income (Gross Receipts + Capital Gains) was omitted from the tax return
- The clock starts ticking on the Due Date of the return or the date the return was filed - whichever is later
- No statute of limitations for
    - Fraud
    - Failure to File

Non-Business Bad Debt

- Treated as a Short-Term Capital Loss (STCL)

Tax Refund Claims

- Must be claimed within (whichever is later)
    - 3 years of return Due Date
    - 2 years of Tax being paid

Section 179 Expenses

- For New/Used equipment placed into service between January 1, 2019 and December 31, 2019
- Max Deduction: **$1,000,000**
- Max Total Equipment Purchases for 2019: **$2,500,000**
    - $1,000,000 deduction is phased out dollar for dollar for the amount of equipment purchases that exceed $2,500,000 (indexed for inflation)
        - If a company buys $2,550,000 in equipment, then the $1,000,000 deduction is reduced by $50,000 ($2,550,000 - $2,500,000)
            - Max 179 Deduction: $950,000
- 100% Bonus Depreciation
    - Use the 179 Deduction first
    - 100% of amount remaining is Bonus Depreciation

Conventions

- Personal Property = Mid-Year/Mid-Quarter
    - Use Mid-Quarter if 40% or more of all purchases occur in 4th quarter
- Real Property = Mid-Month

Carryovers

- Excess 179 expense
- Passive Activity Loss
    - No Carryback
    - Carry Forward Indefinitely
- Investment Interest Expense > Investment Income
    - Carry Forward Indefinitely
- Charitable Contributions
    - Carry Forward 5 years
- AMT Paid
    - Carry Forward Indefinitely
    - Apply against future Income Tax only
        - *Not* against future AMT liabilities

Qualifying Child

- Must be resident of North America
- Under age 19 or age 24, if student

Qualifying Relative

- Must be citizen of North America

- Same "relative" test as the test for medical expenses paid for another person
    - If person is your mother/father or relative closer than a cousin, they don't have to live with you
    - Otherwise, they must live with you
    - Must provide more than 50% support to individual

II. Partnership Taxation

Partnership Basics

- Partnerships are not a legal (taxable) entity
- Income and Expenses flow through to the Partner via a Form K-1

Property For Partnership Interest Exchange

- Non-Taxable Event: No gain or loss recognized
- Partner's Basis = Basis of Property Contributed
    - Exception: When property has a liability that exceeds basis Capital Gain
- Example: $4,000 basis with a $6,000 mortgage for a 20% interest

    $4,000
    <$4,800> ($6,000 x 80%)
    $800 Capital Gain

- $0 basis for partner
- $4,800 basis for Partnership on the property
    - Contributor's Basis + Gain recognized Contributor

Services For Partnership Interest Exchange

- Taxable Event
- Treated the same as compensation

- Use % of partnership interest

  x FMV of partnership

  = Taxable Income

- Taxable Income amount becomes basis

Partnership Holding Period Of An Asset

- Inherits holding period of asset contributed
- Except: Inventory - holding period begins when contributed

Startup Costs For A Partnership

- Tax treatment same as that of an individual taxpayer
- Syndication fees (preparing offering materials, etc.) are not deductible or amortized

Deductions To Arrive At Partnership Income

<COGS>
<Wages> (Except for partners)
<Guaranteed Payments>
<Business Bad Debt> (Accrual basis only)
<Interest Paid> (payments to partners are OK)
<Depreciation> (except 179)
<Amortization of Startup Costs>

= **Partnership Income**

Partnership Losses

- Cannot be taken below basis
- Loss is carried forward until basis is available
- Example:

Beginning Basis:	$2,400
Plus Income:	$200
Minus Ordinary Loss:	<$3,000>
	$0

$400 Loss gets carried forward until basis is available

Guaranteed Payments

- Appear in partner's income during year in which fiscal year **closes**
- Example:
  - 6/1/18-5/31/19 Fiscal Year
  - Even if payment was received in 2018, it is income on the 2019 individual return

Partnership Benefits

- Health Insurance
- Life Insurance
- Treated as guaranteed payments and are self-employment income

Guaranteed Payments

%	Share of Ordinary Partnership Income (Loss) from K1
+	Guaranteed Payments
	<% share of 179 expense>
=	Self-Employment Income subject to Self-Employment Tax

Partner's Basis From Property Contribution

- Contribution of Property: Property's original basis
- Compensation for Services: FMV of % of partnership ownership
- Purchase of a Partnership Interest:
- Amount of purchase = Basis
- Partnership Interest by Gift:
    - Gift Basis rules apply

Items Not Deductible On Schedule K

- Instead, these flow to Partners' K-1
    - **I**nvestment Interest Expense
    - **F**oreign Tax Paid
    - **C**haritable Contributions
    - **179** Expense
- Mnemonic: **IFC179**

Items Not Counted As Income On Schedule K

- Passive Income
- Portfolio Income
- 1231 G/L
- Mnemonic: **PP1231**

Partnership Basis Calculation

(This is a simplistic formula for remembering on exam day)

	Beginning Partnership Basis
+	Capital Contributions
+	Share of Ordinary Income
+	Capital Gains
+	Partner's Share of Partnership Liabilities
+	Tax-Exempt Income (**don't forget this!**)
=	Ending Partnership Basis

Partnership Basis Increase/Decrease

Partnership Basis is **decreased** by:

- Money Distributed
- Adjusted Basis of Property Distributed
- Share of Ordinary Losses
- Partnership is relieved of a liability (distribution)

Partnership Basis is **increased** by:

- Partnership getting a loan

  Example:

Beginning Basis	$15,000
Share of Partnership Income	$22,000
Tax Exempt Income	$500
1231 Casualty Gain	$3,000
1231 non-Casualty Gain	$2,000
LTCG	$2,500
	$30,000
Total	$45,000
Less:	
STCL	<$2,000>
Charitable Contributions	<$3,000>
Ending Basis	$40,000

Note: Guaranteed Payments do not affect basis

Order Of Adjustment To Basis

- Increase basis in share of liabilities
- Increase basis from all income items - including tax-exempt income

- Decrease basis for distribution
- Decrease basis for losses (limited to basis)
- Gains are always allowed in related-party transactions
  - 33% partner sells property to a partnership at a $6,000 gain
  - Partner recognizes a $6,000 capital gain on K-1
- A 50% or more partner who contributes capital gain property to partnership, who in return won't use it as capital gain property, treats the gain as ordinary and so will the partnership

Partnership Taxable Year

- Due Date: 3/15 plus a six-month extension
- Must be the same as 50% of partners and use the same tax year for 3 years

Death Of A Partner

- Taxable year only closes with respect to partner and their partnership interest

Partnership Terminates

- When less than two partners
- Operation Ceases

Sale Of Partnership Interest

- Results in a Capital Gain/(Loss)
- Amount Realized – Basis in Partnership = Gain/(Loss)
- Basis = Capital Account + Liabilities Assumed
- Any assets sold not capital in nature = Ordinary Gain
    - Unrealized Receivables
    - Appreciated inventory

Section 754 Election / Section 743(B) Adjust

- Adjustment amount equals the difference between the value of the outside basis to the transferee partner and the inside basis of the same partner. The objective is to ensure that inside basis of the asset is equal to the outside basis.
    - Optional for Gains
    - Mandatory for Losses
        - Inside Basis > Outside basis by $250,000+

Partner's Share Of Ordinary Gain

FMV of Assets (non-capital)

<Adjusted Basis of non-capital assets>

= Ordinary Gain

x Partnership Interest %

= Partner's share of ordinary gain

Note: Partnerships recognize NO G/L on a Distribution

Distribution: Order Of Basis Reduction

1. Money received
2. Adjusted basis of unrealized receivables and inventory
3. Adjusted basis of other property

Note: Only MONEY distributions will trigger a gain in a partnership distribution

Liquidating & Non-liquidating Distributions

- A loss can **ONLY** occur in a liquidating distribution
- Requirements for a loss to be recognized:
    1. Money was received
    2. Unrealized receivables received
    3. Appreciated inventories received
- Otherwise, no loss recognized
- Example: Liquidating Distribution

Partner's Basis in partnership:	$60,000
Partner Receives property	
Partnership Basis in that property:	$20,000
Partner's Cash received:	$10,000

Note: You ignore the property distribution of $20,000 for this calculation

Basis

<Cash>

<Receivables Received>

<Inventory Received>

<Property Distributed>

Any Remainder = Capital Loss

$60,000	Basis
<$10,000>	Cash Received
$50,000	Basis
<$50,000>	(whatever amount takes basis to zero)
$0	

- Example: Non-Liquidating Distribution

Partner's Basis in Partnership:	$9,000
Money Received:	<$5,000>
Remaining Partner's Basis:	$4,000
Partnership's Basis in Property:	$3,000

Use lesser of partner's remaining basis or partnership's basis in property to calculate partner's basis in property

Basis Remaining:	$4,000
Partner's Basis in Property:	<$3,000>
Remaining Partnership Interest:	$1,000

III. Corporate Taxation

Shareholder Basis In A Corporation

  Adjusted Basis of property transferred
+ Gain Recognized (only if less than 80% ownership)
  <Boot Received> (includes assumption of liability)

= **Shareholder Basis**

- If shareholders have *80%* control after a property transfer, no taxable event occurs.
- If liabilities exceed basis on contributed property to a corporation, a gain is recognized.

Corporate Property Basis Calculation

  Transferor's Basis
+ Gain recognized by shareholder

= Basis

- If you remove all shareholders who contributed services in exchange for ownership in the corporation and the remaining shareholders who contributed property add up to less than 80% ownership, then ALL shareholders have a taxable event.

FMV of Corporate Interest
<Adjusted basis of property>

Gain

- Both shareholders and corporations use **ADJUSTED BASIS** of property for basis purposes, NOT FMV of property.

Section 1244 - Small Business Corporations

A loss on worthless stock is an ordinary loss.

- Taxpayer must be the original stock owner
- Taxpayer must be an individual or a partnership
- $50,000 (Single) or $100,000 (MFJ) limit - remainder is a capital loss
- Must have been issued in exchange for money or property (no interest in exchange for services)
- Shareholder equity must not be in excess of $1 Million
- Both common and preferred stock is allowed

Rules For Filing A Form 1120 (C Corp)

- Return due regardless of income level
- Calendar Year-End
  - Due Date: 4/15
  - 6-month extension (10/15)

- Compare 1120 vs 1120S
    - 1120 - C Corp Return Due 4/15 and 10/15
    - 1120S - S Corp Return Due 3/15 and 9/15

Estimated Tax Payments

- Required if more than $500 in tax liability expected, or
- 100% current year liability
- 100% previous year liability
- Note - If Corp. had > $1M in revenue previous year
    - First Estimated payment based on **previous** year
    - Remainder based on the current year

Minimum Tax Credit

- For tax years beginning after December 31, 2017
- Regular Tax Liability reduced by Minimum Tax Credit
- Refundable Credit

Corporate Organization Costs

- Amortization of costs begin the month the corporation commences business activity
- If the corporation doesn't amortize organization costs in year one, they can never be amortized
- Costs associated with offerings are neither deductible nor amortized

C Corporation Charitable Deductions

Sales

<COGS>

Gross Profit

Gross Profit

+ Rent, Royalties, Gross Dividends, Capital Gains

Total Income

Total Income

<Deductions> (No charitable contributions, Dividends Received Deductions (DRD), or NOL Carrybacks allowed)

<NOL Carryforwards>

Taxable Income before Charitable Contributions, DRD, NOL Carrybacks

Taxable Income before Charitable Contributions, DRD, NOL Carrybacks

x 10%

Deductible Charitable Contributions

- Excess charitable contributions get carried forward 5 consecutive years (No Carryback)
- The Board of Directors can authorize Charitable Contributions up to **3/15 and have them count in the previous tax year**

Dividends Received Deduction (Drd)

- Only allowed if no Consolidated Return is filed
- Qualified dividends from domestic corporations only
- 80% Interest = 100% DRD
- 20-79% Interest = 65% DRD
- <20% Interest = 50% DRD

Drd - Loss From Operations

- Only take DRD % x Taxable Income
- Example:

Sales	20,000
Expense	<22,000>
	<2,000>
Dividend Income	10,000
Taxable Income	$8,000

Taxable Income	$8,000
x DRD Rate	50% (Assume 50% for this example)
DRD	<$4,000>
Taxable Income	$4,000

- If DRD brings a loss situation, you can take full DRD
- If Taxable Income remains after DRD, only a partial DRD (T.I. x DRD %) is allowed

- Example:

Loss From Ops	<$10,000>
Dividend Income	100,000
Taxable Income	$90,000

Assume a 15% ownership interest (for a 50% deduction because it's less than 20% ownership)

$100,000
x 50%

<$50,000> DRD

$90,000 Taxable Income
<$50,000> DRD

$40,000

(Since T.I. remains, only partial DRD can be taken)

$90,000 Taxable Income
x 50%

<45,000> DRD

$45,000 Taxable Income

Example using previous information:

Taxable Income	$40,000
DRD ($100,000 x 50%)	<$50,000> DRD
	<$10,000>

(since a loss occurs, the full DRD is OK)

Corporate Losses

- A Loss on a sale to a Corporation where taxpayer owns a 50% or more interest is disallowed
- Capital Losses Deductible to the extent of Capital Gains
- Net Short-Term Capital Gains taxed at Ordinary Rates
- Corporations can Carryback losses 3 years and Carry Forward losses 5 years as a Short-Term Capital Loss
- Bad Debt losses are classified as Ordinary

Casualty Loss For Corporations

- No floor on corporate casualty loss like there is with an individual taxpayer
- If destroyed, the loss is the property's basis (minus proceeds)
  - Loss Calc: Adj. Basis – Insurance Proceeds
- If partially destroyed, take the lesser of FMV or adjusted basis reduction (minus proceeds)

Net Operating Loss

- Same NOL Rules as Individuals.
- NOL 2018 Tax Year and Beyond
    - Carried Forward Indefinitely
    - Limited to **80%** of Taxable Income (New)
- NOL Tax Years Prior to 2018
    - 20-year Carry Forward
    - No Taxable Income Limitation

M1

- Reconciles book to tax income before Net Operating Loss/Dividend Received Deduction
- Permanent differences (tax-exempt interest)
- Temporary differences (accelerated depreciated tax, straight-line, etc)

M2

- Reconciles beginning to ending retained earnings

	Beginning Unappropriated Retained Earnings
+	Net Income
+	Other Increases
-	Dividends paid
-	Other decreases
	Ending Unappropriated Retained Earnings

M3

- Like M1, but for Corporations with $10M+ in assets

Affiliated (80%) Corporations

- Consolidation election is binding going forward
- Dividends are eliminated
    - Advantage: Gains are deferred
    - Disadvantage: Losses are deferred
- One Accumulated Earnings tax allowed
- In order to Consolidate, the parent must have 80% voting power and own 80% of the stock value

Corporate Distribution - Shareholders

- Use FMV of Property
- Distribution is a dividend to the extent of current accumulated earnings and profits (ordinary income)
- Then, remainder (if any) is a return of basis
- Then, remainder (if any) is a Capital Gain
- Distribution amount = FMV of Property + Cash - Liability Assumed
- **Notes**:
    - If a corporation distributes property with a FMV below basis, there is NO LOSS

If a corporation distributes appreciated property that is capital in nature = Capital Gain

- If a corporation distributes appreciated property that is non-capital in nature = Ordinary Income

- Shareholder Distribution Calculation

FMV of Property
<Liability Assumed>

=Total Distribution

- Order of treatment

1. Distribution is a dividend to the extent of current and accumulated earnings and profits
2. Shareholder basis is then exhausted
3. Remainder, if any, is a Capital Gain

Accumulated Earnings & Profits Calculation

	Beginning Accumulated Earnings and Profits
+	Net Income
+	Gain on Distribution (if not already in book income)
-	Distribution (but cannot create a deficit)
-	NOL of prior years
=	Ending Accumulated Earnings and Profits

- A "Dividend in Kind" is just another way of describing property distributed
- If Current and Accum. Earnings and Profits are positive
    - Deplete current amount with the dividend first
    - Then, deplete the accumulated amount
- If Current Earnings and Profits are positive, but Accumulated Earnings and Profits are negative
    - Deplete only the current amount
- If both are negative, the Current Earnings and Profits cannot add to the deficit
- A Stock Redemption results in a Capital Gain to the shareholder

Complete Liquidation Gain Treatment

- If Capital Property, then Capital Gain
- If Non-Capital Property, then Ordinary Income
- Gain characterization is the same for both the corporation and the shareholder

Complete Liquidation Loss Treatment

- Corporation: Depends on if property is capital in nature, otherwise ordinary loss
- Individual: Capital Loss only

Complete Liquidation Of A Sub

- No G/L to parent company

Consent Dividend

- Consented by the Board of Directors but not yet paid
- Treat as if distributed by the end of the year

Personal Holding Companies

- No banks or financial institutions can be PHCs
- 5 or fewer individuals own more than 50% of the stock
- 60% of the PHC's income must be from passive means
- PHC tax is self-assessing – 20% tax rate

	Taxable Income
+	Dividends Received Deduction
+	Net Operating Loss
-	Federal Foreign Taxes
-	Charitable contributions in excess of 10% limit
-	Net Capital Loss
-	Net LTCG over Net STCL (net of tax)
=	Adjusted Taxable Income

Adjusted Taxable Income
- Dividends paid out during year
- Dividends paid by 3/15
- Dividends Carried Over
- Consent Dividends

= Undistributed PHC Income x 20%

Corporate Accumulated Earnings Tax (Aet)

- Not Self-Assessing like a PHC

Accumulated Earnings Credit

- Take greater of $250,000 ($150,000 for Service Corps) or the legitimate balance based on future needs (i.e. purchasing a building)

S-Corporations

- Shareholders: Only Individuals, Estates, and Trusts
- Domestic only, no International S-Corps
- S-Corps can own a C-Corp, but no Consolidated Return
- Up to 100 shareholders allowed
- Only one class of stock allowed
- Election for S-Corp status must be made by 3/15 and counts as being an S-Corp since beginning of the year

- Calendar tax year only
- 1120S due 3/15 with 6-month extension (9/15)
- To make election, 100% of shareholders must consent
- To terminate, 50% of shareholders must consent
    - No S-Corp election allowed 5 yrs after termination
    - Termination effective immediately following an act that terminates status

S-Corporation Rules

- No Foreign Taxes paid deduction allowed - goes on Schedule K
- No Investment Interest expense allowed - goes on Schedule K
- No 179 Deduction allowed
- No 1231 Gain or Loss
- No Charitable Contributions
- No Portfolio Income

S-Corporation Shareholder Basis

	Beginning Basis
+	Share of Income Items (including non-taxable income!)
-	Distributions (cash or property)
-	Non-deductible expenses
-	Ordinary Losses (but don't take income below zero)
=	Ending Basis

Accumulated Adjustments Account

- Taxed to shareholders but undistributed

Beginning Balance	$50,000
Ordinary Income	$20,000
Ending Balance	$70,000
Distribution	<$100,000>
	$30,000 of distribution is non-taxable

Built-in Gains

- C-Corps that Convert to S-Corps are subject to a tax on the subsequent sale of Corporate Assets
- Prevents a C-Corp from avoiding Double-Taxation by converting to an S-Corp

FMV of Assets @ S-Corp Election Date
<Adjust. Basis of Assets>

Built-in Gain x 21% Corporate Rate

IV. Gift and Estate Taxation

Gift Taxation

- Gift Tax Basics
    - Property transferred while taxpayer living
- Gift Taxation – Donor
    - A $15,000 exclusion for each spouse is allowed for calculating gift tax
    - If a couple gifts $32,000 cash to a friend, the amount of the gift taxable to the couple for gift tax purposes would be $2,000 ($30,000 - $30,000)
    - In order to get the exclusion, the recipient must immediately acquire a present interest in the property and get unrestricted access to the property and all of its benefits
    - If the gift is an annuity, use Present Value to determine the gross gift
- Gift Tax Calculation
    - Recipient must gain all rights to property. If recipient merely gains future ownership, then the present value of the gift is 100% taxable to donor and cannot exclude from gift tax calculation.

      Gross Gifts
      <1/2 of Gifts (treated as given by spouse)>
      <Total donees x $15,000 exclusion>
      <Tuition and Med. Expenses paid directly to org.>

Note: No Books or Dorm fees allowed. Don't let the exam trick you with tuition payments given to beneficiary instead of college.

<Political Contributions>
<Charitable Gifts>
<Unlimited Gifts to Spouse>

= Total Taxable Gifts for Current Year
\+ Taxable Gifts From Prior Years

= Total Taxable Gifts

- Gift Tax – Donee (Recipient)
  - Property received through gifts not income to recipient
  - Loss on Sale of Property
    - Basis is same as Donor, or FMV at time of Sale, whichever is lesser – IRS wants to minimize your loss
  - Gain on Sale of Property
    - Basis is same as Donor
  - No G/L if Donor Basis < Sales price < FMV @ gift date
  - Donor's holding period flows to donee
- Gift Tax Returns
  - Calendar-year basis only
  - Due April 15
  - If appreciated property is gifted and the recipient dies within one year and is transferred back to original owner after death,

basis reverts back to decedent's basis prior to death instead of basis increasing to FMV

- Basically, if you gift an appreciated property worth $10k with a basis of $1k to someone who is about to die and then the property passes back to you from their estate, normally your basis would be the FMV at death ($10k), but the IRS won't let you do that – your basis reverts back to the decedent's basis ($1k) from when you gifted the property to them

Trust Taxation

- Complex Trust
  - Income distributions are optional
  - Accumulation of income OK
  - Charitable contributions OK
    - Contributions using tax-exempt income are not deductible
  - Distribution of Trust Corpus (Principal) is allowed
  - Allowed personal exemption of $100
- Simple Trust
  - Income distributions are mandatory
  - Accumulation of income is disallowed
  - No charitable contributions allowed
  - Distribution of Simple Trust Corpus disallowed

        - Remember – Distribution of Complex Trust Corpus is allowed.
        - A way to remember it is that it’s so complex that they don’t care if you distribute the Corpus
    - Allowed personal exemption of $300
- General Information
    - Expenses and fees from tax-exempt income are not deductible for either a Complex or Simple Trust
    - Trusts can have a Net Operating Loss
        - Any unused NOL flows through to the beneficiaries

Estate Taxation

- Estate Tax Basics
    - Property is transferred after taxpayer’s death
- 2019 Tax Year
    - First $11.4 Million is exempt
- Medical expenses paid after death, but incurred within 1 year of death go on decedent’s personal tax return
- Estate Tax Credits granted for Foreign Death Taxes only
    - Foreign Income and Gift Tax credits disallowed
- Estates can have a Net Operating Loss
    - Any unused NOL flows through to the beneficiaries
- Estate Tax – Decedent

	Gross Estate (Cash + Property FMV @ Death/Alt)
	<Funeral Costs>
	<Estate Admin Costs>
	<Debts/Mortgages>
	<Casualty Losses>
	<Charitable Bequests>
	<State Death Tax>
+	Receivables
	<Payables>
=	**Taxable Estate**

	Taxable Estate
+	Taxable Gifts (Post '76)
=	**Total Taxable Amounts**

	Total Taxable Amounts
x	Estate Tax Rate
=	**Transfer Tax**

	Transfer Tax
	<Foreign Death Taxes Paid>
=	**Net Estate Tax Liability**

- Estate Tax - Joint Tenancy
    - When two non-spouses jointly own property
    - FMV at death x % Ownership = Amount in Estate

    - Example:
        - Brother paid 75% of property
        - Sister paid 25%
        - FMV is $100k at sister's death
        - $25k goes into sister's estate
- Estate Tax – Tenancy By Entirety (Marriage)
    - ½ of marital assets go to deceased spouse's estate
- Estate Tax – Tenancy In Common
    - A, B, and C own property
    - If A dies, FMV of A's share goes to heirs
- Estate Tax – Life Insurance Proceeds
    - Life insurance proceeds in husband's name go onto his estate regardless of beneficiary
    - Exception – he moved it out of his name 3 years prior to death
- Estate Tax – Beneficiary
    - Property received through inheritance not income to recipient
    - Property value is FMV at date of death or 6 mo. later
    - If property is sold prior to 6 mo. date and the alternative date is used, FMV at date of sale is used to value property
    - Basis in property automatically assumes LT holding period

Distributable Net Income (DNI)

- Calculated for both trusts and estates
- DNI = Taxable Income – Expenses (from income production)
- “Allocable to Corpus” means it’s not taxable to beneficiary
- Trust beneficiaries only pay tax if earnings are distributed
- Estate beneficiaries pay tax on DNI, regardless if distributed
- 1041 Fiduciary return due if estate has $600+ gross income
- Administrative fees can be deducted either on 1041 Fiduciary or Estate tax return

V. Property Transactions

Tax Basis In A Property

- Calculation

	Cost of property
+	Purchase expenses
+	Debt assumed
+	Back taxes and interest paid
	Basis

- Back taxes and interest paid by taxpayer are not deductible for assessments on time taxpayer did not own the property - they only add to property's basis.

Gifted Property (Use Basis, Not FMV)

- Sold at a gain:
    - Use donor's basis
- Sold at a loss:
    - Use **lesser** of donor's basis or FMV at time of sale
- Sold in between donor's basis and FMV:
    - No Gain or Loss

Estate Property Inherited (Use FMV, Not Basis)

- Use FMV at death or Alternate Valuation Date (6 mo. later)
    - If Alt. date is chosen but sold before 6 mo. window, use FMV at date sold
- Property inherited is LTCG property regardless of how long you hold it after receipt

Stock Dividend Holding Period

- Holding period of new stock received from a dividend takes on the holding period of the original stock

Sale Of An Asset Gain Calculation

Selling Price (cash received + liability relieved)
<Adjusted Basis of Property>

Gain

1031 Like-Kind Exchange

- Real Property for Real Property only
    - Personal Property no longer allowed under TCJA
- US property only

Example: Like-Kind Exchange (no mortgage) realized gain calculation:

Receiving:

Land FMV	$9,000
Car FMV	$2,000
Cash	$1,500
	$12,500

- Giving up: <$10,000>
- Realized Gain: $2,500 vs. Boot Received: $3,500
  - Use lesser

    Recognized Gain: $2,500

    Basis of New Property:

	Old Basis:	$10,000
+	Gain recognized	$2,500
-	Boot received	$3,500
-	Loss recognized	N/A
	New Basis	$9,000

- Boot = Cash received+ unlike property received + liability passed to other party
- Example: Like-Kind Exchange (with mortgage) realized gain calculation:
  - If you net the mortgages and you have a net boot paid, ignore it for calculating the gain

	Old Basis
+	Boot Paid (Mortgage assumed + Cash or Prop Paid)
+	Gain Recognized
-	Boot Received
=	Basis of New Property

- If the netting of Mortgages results in net boot paid
    - DO NOT subtract the boot paid amount from the cash received
    - Ignore the boot paid amount from the mortgage completely

Involuntary Conversion

- Occurs when you receive money for a property involuntarily converted
- There is no gain if you reinvest the proceeds completely
- If not...

Example:

Received	$24,000	Reinvested	$21,000
Basis	<$20,000>	Not Reinvested	$3,000
Realized Gain	$4,000		

Realized Gain $4,000 vs. Not Reinvested $3,000

Take the lesser... Recognized Gain = $3,000

New Basis:

	Amount paid for new asset	$21,000
-	Deferred Gain ($4,000 - $3,000)	<$1,000>
		$20,000

If you reinvest **LESS** than what is paid to you:

$$$ Paid for New Property
<Amount of Gain not recognized>

Basis in New Property

If you reinvest **MORE** than what is paid to you:

$$$ Paid for New Property
<Deferred Gain - Realized Gain>

Basis in New Property

Sale On Home (Personal Residence)

- $500,000 Gain Excluded (MFJ)
- Must live there 2 out of 5 years
- Loss on sale of home is NOT deductible

Wash Sale

- 30 Day rule applies
- Disallowed loss adds to basis of new stock
- New stock takes on date of acquisition of old stock

Sales Between Related Parties

- Ancestors
- Brother/Sister
- Spouse
- Descendants
- Corporation or partnership where you're a 50% shareholder
- Seller cannot take a loss on a sale, but the gain is always recognized
- Related party gets to use the disallowed loss when sold
    - Never below zero - i.e. a net loss is not allowed
    - Related party's holding period begins when they acquire property
- In-Laws are *not* related parties

Capital Losses (Corporations)

- Capital losses only offset capital gains
- Carryback 3 Years
    - If you elect to not carryback when able, you lose the option in the future
- Carryforward 5 Years - only as an STCL

Capital Gain/Loss Property Classification

- Inventory is NOT a capital asset
- Business property is NOT a capital asset
- A/R is NOT a capital asset
- Covenant not to compete is NOT a capital asset (and your basis is zero)
- Goodwill (internally generated) IS a capital asset

Capital Gains And Losses (Non-corporations)

- Net all STCG and STCL
- Net all LTCG and LTCL

Example:

Net STCG	\$10,000
Net LTCL	<\$15,000>
Net LTCL	<\$5,000>
Deduct	\$3,000
LTCL Carryforward	<\$2,000>

Note: a Carryforward always maintains its character

Capital Losses For Individuals

- Individuals can offset $3,000 of ordinary income with a $3,000 capital loss
- Unused capital losses don't get deducted on decedent's final return, but unused passive losses do
- No Carryback for Individuals allowed

Personal Property Used In Business

- Any G/L on business property held < 1 year is ordinary

1231 Property

- Real or Personal Property held more than a year
    - Inventory is never 1231 Property
- Casualty Losses on 1231 Property
    - Net the losses
        - Net Loss = Ordinary Loss
        - Net Gain = Combine with other 1231 Gains
- 1231 Net Loss
    - If 1231 Losses > Gains, treat as **Ordinary Loss**
- 1231 Net Gain
    - If 1231 Gains > Losses, treat as **LTCG**
- 1231 Gain = LTCG
- 1231 Loss = Ordinary Loss

1245 (Personal) Depreciation Recapture

- You sell a piece of depreciated machinery at a gain
    - Some of gain is treated as ordinary income
        - Amount of depreciation
        - Remainder of the gain is a **1231 LTCG**

  There are **no** 1245 Losses

- 1231 Gain = LTCG

  1245 Gain = Ordinary

  Casualty Gain = LTCG

  1231 Loss = Ordinary

  1245 Loss = N/A

  Casualty Loss = Ordinary

- Example:

Cost of Asset	<$100,000>
Depreciation	**<$47,525>**
Basis	$52,475
Sale Price	$102,000
Basis	<$52,475>
Gain	$49,525
1245 Ordinary	**$47,525**
1231 LTCG	$2,000

1250 (Real) Depreciation Recapture

- You sell a building at a gain

  There are **no** 1250 Losses

- Individuals: Post-1986 property with gain is 1231 LTCG
- If Straight Line depreciation is used, don't use 1250
  - Entire Gain is 1231
- Corps: Section 291 requires 20% of depreciation classified as ordinary gain
  - Remainder is 1231 LTCG

Depreciation Recapture

- Sec. 1245 for Personal Property
- Sec. 291 for Corporate Real Estate

Example: Involuntary Conversion

Amount received from involuntary conversion	$125,000
Price of replacement building	$110,000
Cost of original building	$100,000
Depreciation taken	<$14,000>
Basis	$86,000
Realized Gain	$39,000

Take lesser of realized gain or amount NOT invested

Realized Gain	$39,000
vs	
Amount NOT invested ($125,000 - $110,000)	$15,000
Recognized Gain	$15,000
Ordinary Gain	$14,000 (from depreciation)
1231 LTCG	$1,000

- If you see a 1231 question on your Exam, the amount of depreciation listed represents Ordinary Gain Income
- If any 1231, 1245, 1250 asset is held < a year
  - Gain or Loss is Ordinary

VI. Multi-Jurisdictional Tax Issues

Interstate Income Act Of 1959

- Also called Public Law 86-272
- Restricts a state's authority to tax interstate commerce
    - A state can't collect income tax on sales within its borders as long as the orders are filled and shipped outside of the state
    - Applies to tangible personal property only
        - Services and Intangibles are **not** protected
    - Does not protect a Corporation in the state where incorporated
    - Does not protect from taxes using metrics other than income (e.g. Sales Tax)

Uniform Division Of Income For Tax Purposes Act (UDITPA)

- Also known as the Multi-State Tax Compact
- Uniform criteria for determining taxable income of multi-state corporations
- Designed to ensure a company is not taxed more than once on its income
- Forces a corporation to segregate
    - Business Income
        - Part of the corporation's regular course of business
        - Includes acquisition of tangible and intangible property if such activities are part of the regular trade or business
    - Non-Business Income
        - All income other than Business Income

VII. Professional Responsibilities

Consulting Engagements

- Helps Client to be more efficient with personnel and resources in order to accomplish their goals
- Covered by Statements on Standards for Consulting Services (SSCS)
    - Competence
    - Due Professional Care
    - Planning
    - Supervision
    - Obtain Sufficient Data
    - Must Serve Client Interest
    - Must have an agreement (Written or Oral)
    - Must Communicate with Client
    - Objectivity is required
    - Independence is not required

Accountant's Liability – Negligence

- Proving negligence is the first step to proving fraud
- In order for an accountant to be liable for negligence:
    - Accountant must have had **duty** to perform with due care exercised by an average accountant
    - The client experienced actual **damages**
    - The damages were a **result** of the negligence

Accountant's Liability – Detecting Fraud

- It is not the accountant's job to find fraud and they are not normally liable for not detecting it
- Exceptions that can get an accountant sued:
    - A normal audit following GAAS would have detected it
    - Accountant agreed to take on more responsibility than what is required in a normal audit
    - Accountant words audit report indicating this greater responsibility

Accountant's Liability – Committing Fraud

- In order for Fraud to Exist:
    - Accountant **misrepresents** material fact(s)
        - Immateriality is a defense an accountant can use in a fraud accusation
    - Accountant commits **Scienter**
        - They know something is false or
        - They recklessly disregard truth
        - They intentionally conceal facts
    - Client has actual **damages**
    - Client **reasonably relied** on the misinformation

Accountant's Liability – Third Parties

- The buzzword is "privity" of contract
- Accountants in most situations don't have privity of contract with third parties connected to the client, such as a bank
- The Ultra Mares decision says that accountants are not liable to third parties unless the third-party was an intended beneficiary of the engagement and the accountant knew they would be relying on the financial statements
- Lack of Privity is a defense against
  - Contract breach suits
  - Negligence suits
- Lack of Privity is NOT a defense against
  - Fraud

Common Law Fraud Vs. Constructive Fraud

- Common Law Fraud is basically regular Fraud
  - Misrepresentation of Material Fact
  - Scienter
  - Damages
  - Reasonable Reliance
- Constructive Fraud is Negligence "upgraded"
  - Instead of Scienter, there is Gross Negligence, which is a reckless disregard for the truth

    - CPAs aren't usually liable to third parties for mere negligence, but Gross Negligence (a.k.a. Constructive Fraud) opens the CPA up to be liable to third parties

Accountant-Client Privilege?

- Unlike Attorney-Client privilege, there is no Federal Accountant-Client privilege for non-disclosure of private conversations to a court unless a particular state recognizes such a privilege

Tax Return Preparation

- Accountants have no way of auditing an individual's personal finances and are not required to do so when preparing a return
- Accountant must prepare the return in good faith and ask for more information if something is missing
- When recommending a tax position, the accountant should realistically believe that it would stand up to the scrutiny of a court
- If a past error is found, the accountant should inform the client of this error
    - Contacting the IRS is **not** required
- If client doesn't fix it, then the accountant should reconsider whether they want to do business with the client
- Payment according to refund amount is disallowed
- Contingent fees are OK when
    - Fees are structured relative to judicial proceedings (Example: IRS Audit)

- Court Cases
    - IRS Authorized to require PTINs
        - Not Authorized to charge fees for them
    - Tax Return Preparer suspended from practicing before the IRS can still prepare tax returns and offer tax advice

VIII. Federal Securities Acts

1933 Securities Act

- Governs the issuance of Initial Public Offerings (IPOs)
- Gives investors adequate information for investment decisions and assurance that financial statements and disclosures can be relied upon
- Gives investors recourse against accountants
- Who can sue under the 1933 Act?
  - **Purchasers** of securities only
- Requirements for accountant to be liable:
  - Damages & Material Misstatements **Only**
  - Reliance on financial statements are not a requirement unless purchased more than a year after the security is registered
  - Proving negligence is not a requirement
- Defenses Accountant can use:
  - Accountant used Due Diligence
  - Accountant followed GAAS
  - Damages weren't caused by accountant's work
  - Plaintiff knew of the material misstatements
- Registration Statements must be filed with and accepted by the SEC
  - Must include:
    - Audited financial statements

        - Prospectus
    - Exempt from filing registration statements:
        - Banks
        - Commercial Paper - < 9 mo. Maturity
        - Farmers
        - Co-ops
        - Securities sold by charities
        - Securities sold by governments
        - Securities sold in one state
            - Issuer must be resident
                - 80% of business done in state
            - Investors must be residents
            - Re-sales by investors can't occur within 9 months of issuance to interstate parties
        - Even if a company is exempt from registering under the 1934 Act, they still must adhere to the antifraud provisions of the Act
- Registered Securities include:
    - Stocks
    - Stock Options
    - Stock Warrants
    - Limited Partnership Interests
        - General Partnerships not allowed
    - Bonds

- Registration Form Options
    - S-1 – Long Form or
    - S-2 and S-3 – Less Detailed and preferred by issuers
- Regulation A
    - Issuer can issue $50M of securities per year and be exempt if they file a notice with the SEC
    - Non-issuers (a.k.a. a private individual) can sell $1.5M per year and be exempt

Regulation D

Rule 504	Rule 506
$5M/year Max	Unlimited $$$
Unlimited Investors	Can Solicit & Advertise to "Accredited" Investors

1934 Securities Act

- Governs the trading/selling of securities after the IPO
- Registrants must file:
    - Form 10-K Annual Report
        - Must be audited
    - Form 10-Q Quarterly Report
        - Must be reviewed, but not audited

  - Form 8-K
    - A notice of a material event
    - Filed within 4 days of event
- Who can sue under the 1934 Act?
  - Purchasers and **Sellers** of Securities
- Requirements for accountant to be liable for Fraud:
  - Damages
  - Material Misstatements
  - **Reliance** on financial statements
    - Under 1933, reliance is **not** required. Note this difference
  - **Scienter** or reckless disregard for the truth
- Who can Sue: 1933 vs. 1934 Acts

1933	1934
• Purchasers	• Purchasers • Sellers

- Accountant must have procedures in place to:
  - Determine if Going Concern is an issue
  - Determine if any material related-party transactions occurred
  - Determine if material illegal acts occurred
- Insider Trading Rules
  - Apply to

        - Officers, Directors, & 10% Owners

- Proxy Solicitation Requirements
    - Proxy must give shareholders audited balance sheets from 2 most recent years
    - Requirement holds true even if one class of stock

IX. Business Structures

General Partnerships

- Partnership Basics
    - Two or more people
    - Intend to engage in business for profit
        - Profit is the key element in determining whether a partnership exists
    - Agency/Fiduciary relationship created
    - Limited duration in most cases
    - Corporations and other partnerships can become partners of a partnership
    - Partnership interest is always considered personal property
- Partnership Formation
    - Agreement can be very informal
        - Can be ORAL
        - Can be IMPLIED
            - Intent is to make a profit
    - Must be *written* if partnership activity falls within Statute of Frauds
        - **Can't be completed in 1 year**
        - Even if partners reside in different states, the partnership agreement need not be in writing unless it falls within the Statute of Frauds

        - Dollar amount of transactions has no bearing on whether the partnership agreement needs to be in writing
        - Purchasing Real Estate has no bearing on the partnership agreement
    - Profit-sharing is *equal* by default
        - Unless partnership agreements states otherwise
        - **Unless specified, sharing of losses follows the same pattern as sharing of profits**
- Partner Rights, Authority, & Liability
    - General Partners have joint control over the management of the partnership and its affairs
        - Unanimous vote needed to change the structure of the partnership
        - Each partner has full right to inspect partnership accounting and business
    - Silent Partners
        - Do not make management decisions
        - Have same liability as a general partner
    - Partner has the authority to assign their interest to another party, which merely means that the other party gets that partner's share of the profits and/or capital contribution
        - Assigning of interest does not grant assignee authority to vote on partnership business
        - Assignee does NOT have right to inspect partnership books either
        - Assignor still maintains liability

        - Partner does NOT have the right to assign their interest in partnership property or allow partner creditors to attach a lien
    - Partner Authority (Similar to Agency Law in REG)
        - Actual Authority
            - Has actual authority to bind the partners to a contract
        - Apparent Authority
            - A third-party reasonably believes partner has authority to bind partnership to contract
            - Cannot use apparent authority to add a new partner
            - Cannot use apparent authority to sell or bind partnership assets
- General Partner Liability
    - Joint & Several Liability
        - Partners collectively liable for debts/torts
        - Partners individually liable for debts/torts
        - Creditors must go after partnership assets first before suing partners individually
- Partner Withdrawal
    - Liability on subsequent debts
        - Not liable assuming notice was given
        - Notice must be given to nullify apparent authority

        - People who had knowledge of their role must be personally notified
        - Public must be notified
    - Liability on preceding debts
        - Jointly and Severally Liable
        - Unless creditors grant novation
- New Partners
    - Liability on preceding debts
        - Capital account at risk only
    - Liability on subsequent debts
        - Jointly and Severally Liable
- Partner Death
    - Partner's estate gets a share of partnership profits and capital account
    - Estate does NOT get any partnership assets
        - Remainder of partners own partnership assets
    - Heirs of decedent are not added as partners unless remaining partners unanimously agree
- Winding up Partnership
    - Creditors get paid
        - Partners can also be creditors
    - Distributions in arrears get paid
    - Partners get return of Capital accounts
    - Any remaining distributions

    - *No* documents need to be filed with state to dissolve general partnership
        - One of the few arrangements that don't require this

Limited Partnership

- Limited Partnership Basics
    - Governed by State L.P. laws
        - Must file L.P. certificate with Sec. of State
            - Only General Partners must be listed
            - Future additions or subtractions of G.P. require certificate to be updated with state
    - Unlike G.P., L.P. profits/losses are split according to capital *contributions* by default
    - A General Partner can also be a Limited Partner at the same time
        - An LP, however, cannot also be a General Partner and maintain limited liability
    - LP do *not* have a fiduciary responsibility to the limited partnership
- Limited Partner Authority
    - Limited Partner has no authority as an agent to bind the partnership
    - Limited Partner has the right to inspect records of the business
    - Disadvantage: Limited Partners cannot participate in management decisions and maintain their limited liability

    - L.P. can still vote on partnership business without losing their limited liability
    - L.P. can still consult and advise partnership without losing limited liability (assuming they don't actually make the decisions)
    - New Limited Partner requires all partners (General and Limited) to agree by writing
    - New General Partner in a Limited Partnership also requires all partners to agree
- Limited Partner Liability
    - Advantage: Limited partners are liable to the extent of their capital contributions only
        - Exception – A Limited Partner (who cannot participate in management decisions) becomes involved with management decisions
            - Becomes liable to third parties
            - If they knew of their involvement
- Limited Partnership Dissolution
    - Automatically happens
        - Once final General Partner leaves
        - Time/Events specified in certificate
        - Unanimous consent by partners
        - Illegal activity

Limited Liability Partnership (LLP)

- Majority vote required to form LLP
- Articles of LLP filed with Secretary of State
- Governed by laws of that State
- "Limited Liability Partnership" must be in name
- No General Partners – each LLP partner has limited liability
  - Exception: Negligence of partner or those under partner's supervision

Limited Liability Company

- Members can participate in management and retain limited liability
- Members don't own any interest in LLC property
- Members can assign interest, but not transfer it
- Members divide profits equally unless otherwise stated

Joint Ventures (JV)

- Similar to a General Partnership, except:
  - Generally, a JV is for a single business activity
    - Example: two companies promote a concert
  - Ability to bind other JV partners is limited
- JV partners still have a fiduciary responsibility to JV
- No state filings or paperwork necessary

Corporations

- Corporation Basics
    - Shareholders have limited liability to the extent of their capital contribution
    - C Corporations have a perpetual life and continue even after shareholder death
    - Corporations can make charitable contributions
    - Corporations can loan Directors money
        - If stockholders approve
        - Loaning employees money does not require stockholder approval
    - Corporations are a separate legal entity from their owners and can:
        - Own property
        - Sue
        - Be Sued
    - Corporations must file Articles of Incorporation in State of governance and include
        - Name, Purpose, & Powers of Corporation
        - Name of Registered Agent & Incorporators
        - Stock share classes authorized & Par Values
        - Name of Corporate Officers NOT required
    - Corporate Board adopts Bylaws to govern company business
- Biggest Advantages of a Corporate Structure

    - Ability to Raise Capital
    - Limited Liability
        - Exceptions that "Pierce the Veil"
            - Commingling of Assets
            - Fraud
            - Under-capitalization
    - Ease of ownership transfer
- Biggest Disadvantage of a Corporate Structure
    - Double Taxation
- Beginning a Corporation
    - Corporations are formed by Promoters
        - Issue Prospectus
        - Arrange Capital
        - Fiduciary of Corporation
            - Profiting from work performed is OK if Corporation is aware of it
    - Corporations are not liable for pre-incorporation actions taken by Promoter
        - Unless Corporation adopts
        - Promoter personally liable unless 3rd party agrees to a novation and releases Promoter
    - Corporations are only Incorporated in one State
        - Become a "Domestic" Corp. in that State
        - Become a "Foreign" corp. in any other State

- Corporate Stock
    - Valid consideration must be given for shares
        - Cash, property, or services performed
        - No promises to pay or perform services
    - Common Stock
        - Dividends are NOT a shareholder right
        - Once declared, dividends become a liability
    - Preferred Stock
        - Carries no voting rights
        - Gets first rights to dividends and liquidation
        - Undeclared Cumulative PS Dividends
            - Accumulate
            - Corporation must pay before issuing dividends to Common Stockholders
        - Participating Preferred Stock gives shareholders right to dividends in addition to what they get as Preferred Stockholders
    - Treasury Stock
        - No Gain/Loss recognized on Sale
        - Have no voting rights
        - Can be re-purchased below Par
        - Cannot produce Dividends
    - Stock Subscriptions
        - An offer to buy shares of stock

        - Must be accepted by Corporation to be valid
        - Offer cannot be revoked for 6 months
        - Subscriber becomes liable once accepted
- Shareholders, Employees, Directors, and Officers
    - Corporations are liable for torts by employees
        - *Respondeat Superior*
        - If committed within normal scope of job
        - Even if they were disobeying orders
    - Corporate Officers
        - Appointed by Board of Directors
        - Act as Agents
        - Owe a Fiduciary Duty to Corporation
        - Corporations can pay for their Officers' legal fees in defending a lawsuit brought on them from carrying out their normal duties
            - Exception: If shareholders bring a suit against the officers, the corporation cannot help defend them
    - Board of Directors
        - Elected by Shareholders
        - Owe Fiduciary duty to Corporation
            - Any conflicts of interest must be disclosed and approved by majority
            - Any dealings must be made like an arms-length transaction

        - Must act in good faith to avoid being liable for bad judgment
        - Good faith is not a defense for negligence
    - Ultra Vires
        - Corporation management acting beyond what the Articles of Incorporation allow
        - Shareholders can sue for Ultra Vires
    - Shareholder Rights
        - Shareholders can inspect Board minutes and records only if request is in good faith
- Mergers & Consolidations
    - Boards must approve
    - Shareholders must approve by Majority
    - Disapproving shareholders can get an appraisal and get their stock back at current market price
    - Merger does NOT need creditor approval
- Professional Corporations
    - Shares owned only by licensed professionals
    - Limited Liability for debts
    - Personal Liability for negligence

S-Corporations

- Advantage
    - Avoidance of Double Taxation
- Disadvantages
    - One class of stock & < 100 shareholders
    - Shareholders must be US Citizens/Residents

X. Contract Law

Contract Offers And Acceptance

- Acceptance can be written or oral
- Must be accepted by intended party (offeree)
- Acceptance can only be made by a party who knows an offer has been made and has all of the facts – a.k.a. a “meeting of the minds”
    - They must “intend” to accept
    - Acceptance should be in form required by offeror
        - If Offeror requires certified mail and you send an e-mail – it’s not acceptance
    - If offeree accepts but puts added stipulations, it is not acceptance, but instead becomes a counter-offer and the original offeror is now the offeree
- If offeror dies or becomes insane before acceptance, offer is void
    - Contract is binding if acceptance occurs before death/insanity

Contract Revocation

- Offeror can revoke an offer, but the revocation doesn’t count until the offeree receives it
- If offeree finds out before acceptance that the offeror has sold the item, it counts as revocation, and they cannot accept

- Option – some amount of consideration (like money) is put forth by offeror to keep the offer open for a stated period
    - Offeror cannot revoke until the time has lapsed on the option
    - Initial rejection by offeree doesn't void the option

Requirements Contracts

- These are contracts where someone becomes the "exclusive" provider of something in exchange for consideration
- Companies can't get locked into one and then have market conditions force them to sell something at what has become an unreasonable price

Promissory Estoppel

- Basically, you can't tell a charity, "Hey, if you buy this $100,000 piece of land, I'll pay for the building that will go on it." and then renege on your promise
- Promises to donate are legally enforceable

Invalid Contracts

- Fraud in the Execution
    - Person didn't know they were signing a contract
    - Void
- Fraud in the Inducement

    - Person knew they were signing a contract but were mislead as to what they agreed to
    - **Voidable**
- Not Competent to Contract
    - Person unable to enter into a contract due to incompetence - **Voidable**
- Duress
    - Extreme - Void
        - Gun to their head and were forced
    - Simple - Voidable
- Undue Influence
    - Voidable
        - Parents get 18-year-old to sign contract
- Illegal
    - Void
    - Contract was illegal in nature
        - Person signed a contract to be a hitman
- Error
    - Unenforceable
        - Person signs a contract to pay $500.00 to have their lawn re-seeded, but due to clerical error, it reads $5000.00

Fraud in the Execution

- Void

Fraud in the Inducement

- Voidable

Not Competent to Contract

- Voidable

Undue Influence

- Voidable

Duress - Extreme

- Void

Duress - Simple

- Voidable

Illegal

- Void

Error

- Unenforceable

Contracts Made Under The Statute Of Frauds

- These contracts must be in **writing**:
  - Cannot be completed within one year
  - Involves the purchase of real estate
  - $500+ Sale of Goods
  - Co-signing and guaranteeing the debt of another

Parol Evidence Rule

- Prevents one party to a written contract from coming in after the fact and claiming that a certain conversation took place that contradicts what is agreed upon in the written contract
- It also prevents using an oral argument to read into the meaning of what is written on paper
- If it's on paper, it trumps what was agreed to orally, before the written contract
- Caveat
  - The Parol Evidence Rule does not:
    - Negate oral agreements made after the written contract
    - Disallow oral words to clarify ambiguous contract language

Contract Assignment & Discharge

- Contracts are assignable to a third-party beneficiary but must be done so in good faith
- Obligations may be assignable
    - Assignor is still liable
    - Assignor may be released from liability if other party grants a novation
- Contracts can be discharged by Law when:
    - Party under Contract is bankrupt
    - Party under Contract dies or is incapacitated
    - Party cannot physically complete the Contract
        - They are in prison, so they can't finish building the new addition to your house

XI. Secured Transactions

Attachment

- When a security interest is legally enforceable
  - Secured interest must be supported by consideration
  - Debtor must own the rights to the collateral or have possession
  - Secured interest must be recorded

Perfection Of Interest

- Gets higher priority over others claiming rights to collateral after the perfection takes place
- Attachment must take place first before Perfection
- Perfection occurs by:
  - **Filing** Financing Statement
  - **Possessing** the Collateral
- Automatically Perfected when
  - Store sells a consumer good on credit
    - Store retains security interest
  - A bank finances the purchase of a consumer good
    - Bank retains security interest
- Priority Rules
  - If two parties are perfected, then the first one to file wins
  - If neither party is perfected, then the first one to attach wins

Creditors Holding A Lien

- Holds priority over claims to collateral vs. unperfected security interests
- Beats perfected security interests filed after lien attachment
    - Exception: Purchase money security interest, which has a 20 day grace period to be filed
- Buyers purchasing in the ordinary course of business are immune from security interests held by merchants

XII. Bankruptcy & Debt

Bankruptcy Basics

- Bankruptcy gives debtors protection from their creditors and stops them from either permanently (Chapter 7) or temporarily (Chapter 11 or 13) collecting a debt
- Filing halts all collection; grants “automatic stay”
- Stops creditors from suing debtor
- Bankruptcy does not stop collections on
  - Student Loans
  - Income Taxes from the previous 3 years
  - Alimony & Child Support
  - Debts/judgments resulting from drunk driving
  - Pension Obligations
  - Debts relating to SOX Violations
  - Debts arising from illegal activities
  - Debts not listed in the Bankruptcy Filing
- Owning a bankrupt corporation doesn’t affect the owner’s ability to file Bankruptcy
  - Corporations are *dissolved*
  - Individuals are discharged
- Bankruptcy stops judgment lien on property included in Bankruptcy Estate

- Bankruptcy attorneys must file a statement showing their payment for Bankruptcy services so that the court can review and make sure that the legal fees are reasonable
- If a debtor fails to keep good records or falsifies documents, a Bankruptcy discharge will be denied

Chapter 7 Bankruptcy (Liquidation)

- Chapter 7 discharges all non-exempt debt
- Can only be filed every 8 years
    - Remember: "8" looks like the letter "B"
- Businesses disallowed from Chapter 7 Bankruptcy
    - **R**ailroads
    - **B**anks
    - **I**nsurance Companies
    - **S**avings & Loans
    - Think – **7**th Inning and your team needs **RBIs**
- Voluntary Filing
    - Must pass Means Test
        - Your State income must be below the Median
            - Note – Median, not Mean
- Involuntary Filing
    - In some cases, your creditors can force you into Chapter 7 or Chapter 11 Bankruptcy

    - Creditors must be able to prove that they are not being paid on time (i.e. debtor is insolvent) or that within the past 120 days the debtor assigned a custodian of the secured property
    - If 12+ unsecured creditors
        - At least 3 must file
        - Claims must be more than $16,750 (New)
    - If less than 12 unsecured creditors
        - Only 1 must file
        - Claim(s) must be in excess of $16,750 (New)
    - Upon filing, a judge will declare an order for relief unless the debtor protests
    - Businesses disallowed from involuntary filings
        - Charities
        - Farming
    - If the debtor pays the court-assigned bond to keep a property in an involuntary Bankruptcy, they can reclaim possession of their property from the interim Bankruptcy Bankruptcy trustee
- Remember – If you see an answer on the CPA Exam that states that Bankruptcy can be commenced against any debtor, that option is WRONG.

Chapter 11 Bankruptcy (Business Repayment)

- Allows a business a reprieve from creditors
- Creates a payment plan for the debt
- Business remains in operation
- At least 2/3 of each debt class of creditors must consent to reorganization
- Ch. 11 Involuntary petitions are allowed

Chapter 13 Bankruptcy (Personal Repayment)

- Similar to Chapter 11, but for individuals
- Gives individuals a reprieve from creditors
- Creates a payment plan for the debt
- Ch. 13 Involuntary petitions are not allowed

Bankruptcy Trustee

- Optional – Creditors decide
    - Can be elected by creditors
    - Can be appointed by the court
- Represents the Bankruptcy Estate
    - Can sue
    - Can be sued

- Paid a reasonable amount for services
    - Fee cannot exceed a certain amount of Estate
- Prior associations with the debtor not allowed
- Oversees Bankruptcy and watches for
    - Preferential creditor payments
        - Trustee can void payments on antecedent (past) debts that occur within 90 days of a Bankruptcy filing
        - A Trustee cannot void a payment made to a creditor that is an even swap (contemporaneous exchange) and for new value
            - Example: A company orders inventory and pays for it upon arrival. 2 Months later, they declare Bankruptcy. This is not voidable because it was an even exchange/new value and wasn't payment for a prior debt.
        - A voidable preference must be on an old debt where the debtor is basically picking and choosing which creditors they send money to (a.k.a. a voidable preference)
    - Preferential Transfers can be voided if
        - Made within One Year of Bankruptcy to "insider"
            - Corporate officers/directors
            - Partners
            - Relatives
        - Made within 3 Months of Bankruptcy "non-insider"
        - Creditor receives larger payment than Bankruptcy liquidation would have granted

- Oversees priority transfer of assets to creditors
    - Secured Creditors
        - Superior to claims of other types of creditors
        - Can take either collateral or cash proceeds from the sale of an asset
        - If collateral doesn't satisfy the amount owed, Secured Creditors become a general creditor for the difference.
    - Unsecured Creditors Order of Priority
        - Court Costs and Fees
        - Child Support & Alimony
        - Expenses from ordinary course of business during bankruptcy proceedings
        - Wages owed to employees
        - Retirement contributions within last 6 months
        - Consumer deposits for undelivered goods
        - Taxes
        - Other general unsecured claims
        - Remember – Taxes have a low priority and are only slightly more important in a Bankruptcy than other unsecured creditors (like a CPA firm that is owed money for services not related to the Bankruptcy)
- If a Landlord files Chapter 7, the Bankruptcy Trustee can act in the best interest of the creditors and assign the leases under contract to the creditors
- The Trustee has 60 days to assume leases on equipment after Bankruptcy is granted or the leases will be rejected

Bankruptcy Estate

- The Bankruptcy Estate is the pool of assets available to creditors until liquidation
- Bankruptcy Estate Exemptions
    - Creditors are not allowed to take
        - Social Security
        - Disability payments
        - Unemployment, Child Support, Alimony, Wages, Pensions, Annuities to the extent that they provide reasonable support for debtor and dependents
- Inheritance/Insurance payments received within 180 days of filing for a Chapter 7 Bankruptcy become part of the Bankruptcy Estate – i.e. creditors can get their hands on it for repayment

Creditors - Garnishments

- Court allows a creditor to garnish or take a portion of the debtor's paycheck

Creditors - Liens

- Mechanics Lien
    - Lien on real property to secure payment for a repair/improvement done to the house

    - A contractor builds an addition to your house, but you lose your job and can't pay the bill. They can't "repo" your house, so they get a Mechanics Lien that sticks until you sell your house.
- Artisan's Lien
    - Applies to personal property like a car
    - If the dealership does $500 in repairs to your car, you don't get the car back until you pay

Creditors – Release From Debt

- Composition of Creditors
    - Two or more creditors agree to release you from debt for less than you owe

Surety (Co-Signing)

- A third-party agrees to be liable for a loan
    - A parent co-signs on their child's car loan
- A surety is primarily liable
- Surety can be released from liability if the creditor behaves in a way that increases the risk that they initially agreed to
    - Example: Creditor won't accept debtor's payments that will extinguish the debt
- Surety can be released from liability if the debtor changes the loan agreement in a way that materially increases the surety's risk
- Cosurety

        - Two sureties are guaranteeing the same debt
        - Liable proportionately
            - If one cosurety is released from their obligation, then the remaining cosureties have their proportionate share reduced by the released party's percentage
            - If 2 people are cosureties for a combined $10,000
                - Person #1 is a cosurety for $1,000
                - Person #2 is a cosurety for $9,000
                - Person #1 is released (10% of amount)
                - Person #2 has their liability reduced by $900 (10% x $9,000)
        - If one surety pays more than their proportionate share of the risk
            - Other sureties must compensate them for the difference
                - Called *Right of Contribution*

Guarantor

- Similar to surety, but a guarantor is secondarily liable

Debtor Rights

- Fair Debt Collection Practices Act
    - Your creditors have the right to collect from you, but not abuse you or embarrass you

- Can't contact you once you have an attorney
- Can call other people to find out where you are, but can't identify themselves as collectors
- Must stop calling you at work if you send them a certified letter
- Must call you only at reasonable hours of the day – according to your time zone, not theirs

XIII. Employment & Environmental Law

Federal Unemployment Tax Act

- An employer-paid tax
    - Must file return and pay even if only one employee works there
    - Deductible to company
    - Not deductible by the employee
- Allows employers to credit the FUTA liability by the amount of State Unemployment Tax (SUTA) they pay

Fica & Social Security

- Employer withholds from employee's paycheck
- Must match employee's withholding
    - If employer under withholds, they are required to make up the difference
- Self-employed individuals must pay both the employer and the employee share, aka "Self-Employment Tax"
- People drawing Social Security may have their benefits reduced if they go back to work and earn an income

Workman's Compensation

- Employees injured on the job get protection, even if they messed up and caused the injury themselves
    - Exception: If the employee intentionally harmed themselves, there is no Workman's Compensation

Age Discrimination Laws

- Protect people ages 40 and above at companies where at least 20 people are employed

OSHA

- Employers should promote a safe workplace and environment for their employees to work in
- Injury records must be kept
- Penalties can be both
    - Civil
        - $1,000 fine per day
    - Criminal
        - Could include Imprisonment
- Employer can require a search warrant for OSHA to investigate their facilities

Civil Rights

- Employers are forbidden from discriminating for
    - Sex
    - Race
    - Religion
    - National Origin

Environmental Protection Agency (EPA)

- Has the power to assess civil penalties for violating environmental laws like the Clean Air Act
- The EPA can sue violators
- Citizens can sue violators
- States can sue violators
- Citizens can even sue the EPA to force enforcement
- For hazardous waste sites: owners, operators, transporters, and lenders associated with the site can be held liable

XIV. Agency Law

Agency Law Basics

- Agency Law deals with someone's ability to bind you to a contract with a third-party
    - A contract is NOT required and an Agency agreement is not based on Contract Law
        - Exception – If duties cannot be performed within a year, a signed writing is required
    - Both parties must consent to the relationship and intend for an Agency relationship to exist
    - Agent owes Principal fiduciary duty
    - Principal doesn't owe Agent fiduciary duty

Authority

- Actual Authority
    - Actual Authority is what is expressly granted or is implied by the duties you expect the Agent to perform and is necessary to carry them out
    - Implied authority
        - When authority is expressly granted, it is implied that the agent has the authority to carry out the duties
            - Example – Authority to pay bills and manage employees if the duty is to run a store

            - Does not include authority to sell or alter the business

- Apparent (Ostensible) Authority
    - Apparent Authority is based on the third-party's perspective – they believe that the Agent has the authority to enter into a contract based on
        - Prior dealings with the Agent – In the past, they had the authority to buy 10,000 widgets, so it is believed that they still have the authority to do so
        - Agent has been given a title that would lead the third-party to believe that they can enter into a contract. Example – Football player calls a man "His Agent" – Football teams then believe he has the power to negotiate a contract for the Football player
        - The Principal hires the Agent to carry out duties that normally carry with them the right to enter into contracts – Using the Football player example; Agents are usually hired to negotiate contracts, so a Football team could legitimately believe that an Agent had the authority to do so
- Actual vs. Apparent Authority
    - Actual – Football player hires Agent to execute contracts for him
    - Apparent – Football player hires a guy to manage some of his affairs, calls him his "Agent", tells Football teams that he's his Agent, but doesn't intend for him to execute contracts for him
    - In both cases, the "Agent" can bind the Football player to contracts though both Actual and Apparent Authority

    - Actual Authority – You have been granted it
    - Apparent Authority – Third-Parties legitimately believe that you have it
    - Both are binding to Principal (Football player)
    - Remember – if an agent exceeds their authority and the third-party doesn't know this
        - If it's reasonable for them to believe that the agent has the authority to execute a contract (the third-party has worked with agent before on similar deals)
            - The Principal is bound to the contract due to Apparent Authority
            - If the Third-party needs to sue in order to force the Principal to perform, the Third-party will win
- How do you terminate an Agency relationship?
    - Both Agent and Principal agree to terminate
    - Principal fires Agent
    - Agent fires Principal
    - Agent breaches their contract by doing something like violating their obligation to act as a fiduciary to Principal
- How do you terminate Apparent Authority?
    - Let the public know
    - Let the people or entities with whom the Agent previously interacted know
    - In cases of death, or Principal is otherwise not competent to contract, ALL authority is revoked
- Agency Coupled with an Interest

    - Agent acquires an ownership interest in the Agency
    - Can only be terminated early (before the interest expiration date) by the Agent
    - Unless the Agency has a specific time limit spelled out in a contract, the Agent's authority is irrevocable by the Principal
        - The Agent is working for the Principal and gets an interest in the Agency in lieu of payment
        - The Principal can't just fire the agent at any time in this scenario unless there is a contract that specifies when it ends
        - The Agent, on the other hand, can leave at any time without being liable
    - An example of an Agency Coupled with an Interest is a lender holding the liquidation rights of certain property in case the borrow defaults
- Agency and Employees
    - Employees who injure third parties while acting within the scope of their duties
        - Both Employee and Employer are liable
    - Delivery truck is speeding and plows into a car on the way to dropping off some boxes
        - Both truck driver and employer can be sued
    - Delivery truck driver decides to take the truck to the casino 30 miles down the highway on a Friday night after work and plows into a car
        - Only truck driver is liable
- Liability for Agents acting outside of their authority

    - Agents are liable for torts (civil wrongs) committed whether they had authority or not
    - Agents who act outside of their authority will be liable for the act (i.e. they bind the Principal for 10,000 widgets at X price. Third-party can sue the Agent for non-performance)
        - Exception – Principal ratifies the contract which relieves Agent of liability
        - To ratify, Principal must know all facts
        - Principal must ratify before third-party cancels agreement
        - If Principal keeps the benefits of the contract, ratification is implied
        - Contract must be 100% ratified or there is no contract
- Liability when acting for an Undisclosed Principal
    - Agent liable to the third-party even if acting within authority
    - Third-party can sue both Principal and Agent if Principal becomes disclosed
    - Agent can then sue Principal

Power Of Attorney

- Must be in writing
- Must be signed by person granting the POA
    - Agent doesn't need to sign
    - General POA

        - Agent authorized to handle all affairs
    - Special POA
        - Agent authorized to handle only specific affairs
    - Ends upon death of Principal

XV. JOBS Act

- Don't memorize – be *generally familiar*
- Title I – Reopening American Capital Markets to Emerging Growth Companies
    - Key: Emerging Growth Company IPO
        - Annual Revenues less than $1B
        - **2 years** of Audited F/S Required
- Title II – Access to Capital for Job Creators
    - Reg. D, Rule 506 adjusted to allow for General Solicitation/Advertising to Accredited Investors
- Title III – Crowdfunding
    - Securities may be sold in small amounts to a large number of Investors
- Title IV – Small Company Capital Formation
    - Reg. A Capital ceiling raised from $5M to $50M
- Title V – Private Company Flexibility and Growth
    - Raises registration threshold from 500 to 2,000 Shareholders if less than 500 non-accredited investors
- Title VI – Capital Expansion