ISSUE 5, 2023

NEBRASKA CPA

Nebraska Society of CPAs Ushers in New Era of Leadership

OFFICIAL PUBLICATION OF THE NEBRASKA SOCIETY OF CPAs

HAVE A Laugh!

INCREMENTAL MATURITY
BY NITIN BHOJRAJ, CPA, CFE

"AFTER SURVIVING THREE MERGERS, OUR CEO REQUESTED NEW FURNITURE FOR HIS OFFICE."

NEBRASKA CPA

ISSUE 5, 2023

CONTENTS

Cover Photo: *Chairman Kelly Martinson, Chairman-Elect Brian Klintworth, and Secretary Jodi Eckhout visit during the NESCPA Fall Conference in Ashland.*

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Certified Public Accountants

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NEBRASKA SOCIETY OF CPAS USHERS IN NEW ERA OF LEADERSHIP

BY JONI SUNDQUIST, NEBRASKA SOCIETY OF CPAS

IN A STUNNING HILLTOP LOCATION overlooking the Platte River Valley, the Nebraska Society of CPAs recently celebrated the election of a new cadre of talented CPAs to spearhead the organization for the 2023-2024 fiscal year. The election took place on Oct. 30 at Mahoney State Park's Crete Carrier Riverview Lodge during the Society's Annual Meeting, which coincides with the NESCPA's two-day Fall Conference.

Since its inception in 1928, the Nebraska Society of CPAs has thrived on the dedication and expertise of its member volunteers. Their commitment has not only shaped the Society but also significantly impacted the Nebraska CPA profession at large.

Reflecting on the importance of volunteerism, newly elected Society Chairman Kelly Martinson of Bennington emphasized, "The strength of our Society lies in the diverse experiences and insights of our members. This coming year, I look forward to working alongside a team of exceptional leaders, all committed to forging a dynamic future for the Society." With more than 28 years of experience in taxation, Martinson is a tax shareholder at Lutz in Omaha. She has served five years on the Society Board, as secretary for two years, and currently serves on the Women in Accounting Committee. "The dedication of our members is what truly drives innovation and progress in our profession," she added.

Echoing this sentiment, Immediate Past Chairman Lori Egger of Ashland shared, "My time with the Society has been a testament to the power of collaborative effort. It's the collective action of our members that steers our profession towards excellence." Egger serves as the CFO of CyncHealth in both Nebraska and Iowa and has more than 26 years of public accounting and tax experience. Her service to the Society includes seven years on the Society Board, and six years on The Foundation of the Nebraska Society of CPAs Board of Trustees. Egger has also volunteered on the Not-For-Profit Committee for more than 20 years, five of those years in a leadership position. In addition, she presently serves on the Women in Accounting Committee.

"Being involved and volunteering for the Nebraska Society of CPAs has deepened my connection to the profession," said Chairman-Elect Brian Klintworth of Lincoln. "I strongly encourage every member to dedicate some of their time and expertise to help advance the CPA profession. It's a great way to make a difference and brings a sense of personal fulfillment as well," he said. Klintworth is a partner at HBE LLP in Lincoln. In addition to his board service and new role as Society chairman-elect, he is presently chairman of the Society's Continuing Professional Education (CPE) Committee.

These voices echo a long-standing tradition within the Society, one where the fusion of fresh ideas and seasoned expertise continues to propel the accounting profession forward. As the Nebraska Society of CPAs steps into a new calendar year, it stands on the cusp of transformative change, driven by an energetic, engaged leadership team.

Congratulations to all of our newly elected officers and board members for the coming year. Also thank you to those continuing their service on the Society Board of Directors.

Thank You!

We extend our sincere gratitude to **Erica R. Parks** of FORVIS LLP in Omaha, **Linda M. Scholting** of Doane University in Crete, **David E. Swan** of SP Group PC in Lincoln, and **Jessica L. Watts** of CRCC in Omaha whose terms on the Society Board of Directors have come to an end. Parks is a past Society chairman and has served on the Nebraska Society of CPAs Board of Directors for five years; Scholting has served on the Society Board for three years; Swan has been the Society's treasurer for the past five years; and Watts has served on the Society Board for three years.

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HBE LLP, Lincoln

SECRETARY
Jodi M. Eckhout
Woods & Durham
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TREASURER
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Buckley & Sitzman LLP,
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Fairbury

NEWLY ELECTED DIRECTOR
Laurie Ann J. Buhlke
Contryman Associates PC,
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CyncHealth, La Vista

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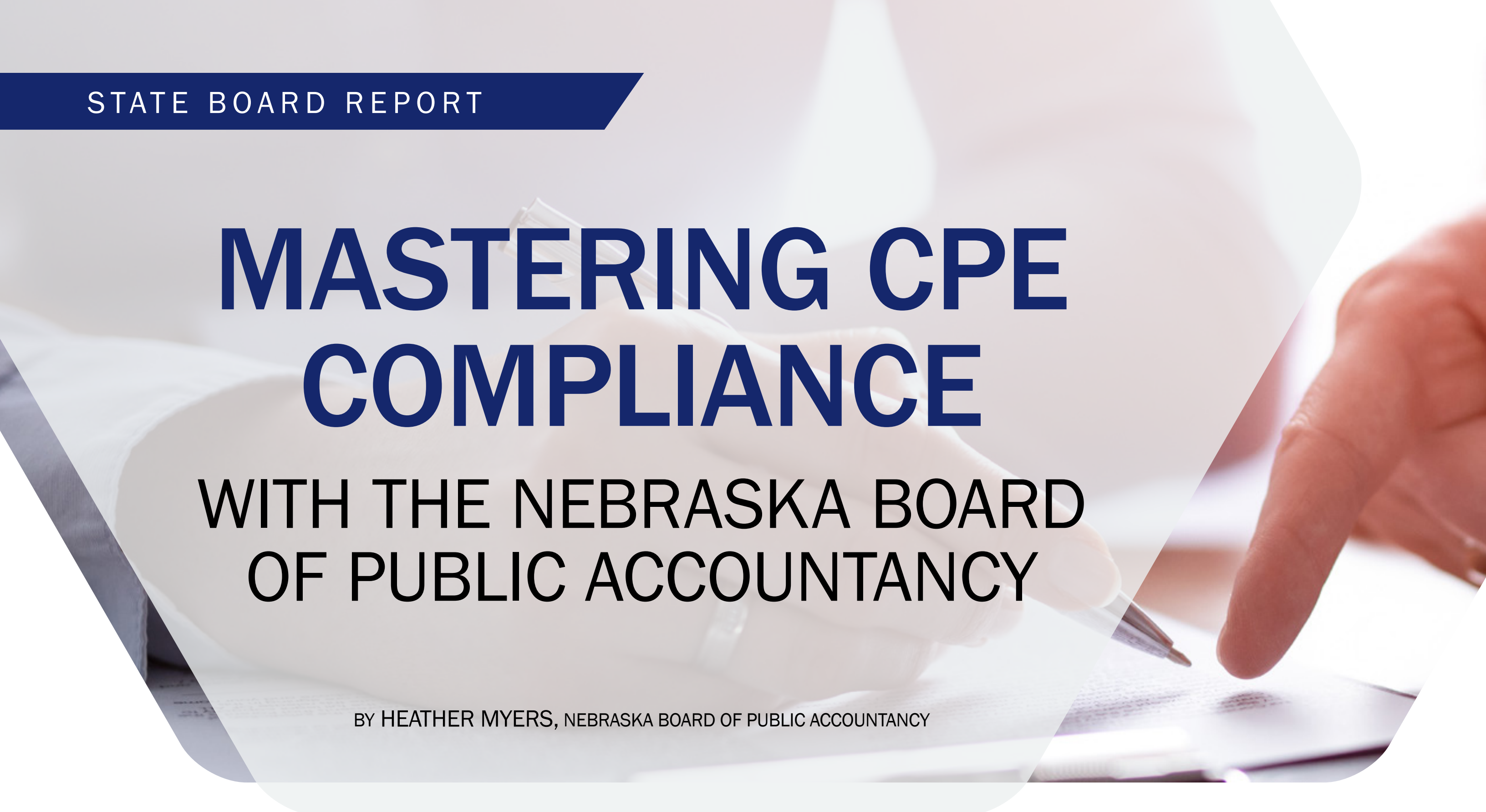
WEST NEBRASKA CHAPTER PRESIDENT
Dana J. Weber
Dana J. Weber, CPA,
Scottsbluff

Without a doubt, leadership and involvement are the greatest contributions you can make to your Society and your profession. Thank you to each and every one of these individuals for their ongoing commitment to the Society and the CPA profession.

Joni Sundquist is president and executive director of the Nebraska Society of CPAs. You may contact her at (402) 476-8482 or joni@nescpa.org.



STATE BOARD REPORT

MASTERING CPE COMPLIANCE

WITH THE NEBRASKA BOARD OF PUBLIC ACCOUNTANCY

BY HEATHER MYERS, NEBRASKA BOARD OF PUBLIC ACCOUNTANCY

AS THE FISCAL LANDSCAPE CONTINUES TO EVOLVE, CPAS FIND themselves in a constant pursuit of knowledge and skill enhancement. The Nebraska Board of Public Accountancy recognizes the importance of staying ahead in the realm of accounting, which is why compliance with Continuing Professional Education (CPE) requirements is imperative for all active permit holders.

Reporting & Documentation: Your Responsibilities

CPE credits must be earned within the calendar year 2023, completed by Dec. 31, 2023, and promptly reported to the State Board no later than Jan. 31, 2024. Adhering to these specific timelines is fundamental as it ensures strict compliance with Nebraska's CPE requirements, safeguarding the professional standing of permit holders.

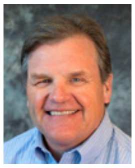
Every Jan. 31, permit holders are required to submit their participation in continuing education activities during the preceding calendar year. In the event that meeting this deadline proves challenging due to valid reasons, it is crucial to communicate your situation in writing to the Board before Jan. 31. Communication is key to maintaining the integrity of the certification process and upholding the standards of the profession.

The responsibility of documenting these requirements rests solely with the permit holder. Evidence supporting your fulfillment of these requirements must be retained for six years after completing the educational courses. Accepted forms of evidence include certificates of completion from course sponsors, signed attendance sheets, grade reports or transcripts from educational institutions, and signed statements of hours from instructors.

Understanding CPE Requirements: A Recap

To ensure the renewal of your Active Permit to Practice, you are required to complete 80 hours of CPE, including four hours dedicated to ethics, within the two calendar years preceding your renewal. These CPE hours must be earned by Dec. 31 of the year prior to renewal and reported to the State Board no later than Jan. 31 of your renewal year. For permits issued after July 1 of the year preceding expiration, CPE hours are pro-rated to a minimum of 40 hours, which is required for renewal. It's important to note that the AICPA Professional Ethics Exam, while vital for certificate issuance, cannot be utilized for permit renewal ethics CPE credits.

Staying abreast of CPE requirements is not just a compliance matter but a commitment to excellence in the field of accountancy. By understanding and fulfilling these obligations, CPAs ensure their knowledge remains current and relevant, enabling them to provide high-quality financial services to their clients and uphold the standards of the profession. For additional guidance and resources, please visit the Nebraska Board of Public Accountancy at https://nbpa.nebraska.gov.



The Nebraska Board of Public Accountancy administers public accountancy law in Nebraska. If you have any questions or concerns regarding CPE requirements, do not hesitate to contact State Board Executive Director Dan Sweetwood at dan.sweetwood@nebraska.gov or Business Manager Heather Myers at heather.myers@nebraska.gov.

ONE TIMES GROSS:
IS THAT THE LAW?

BY ACCOUNTING PRACTICE SALES

"ACCOUNTING PRACTICES ARE WORTH one times annual gross revenue." This belief has been around our profession for decades and, in fact, still drives the marketplace. No one can really explain why one times gross is such an accepted formula. (The best theory is that it assumes a backdoor cash flow. Buyers believe they can achieve a certain income level despite what the previous owner has done.) Whatever the reason for the widespread thought, it is so persistent that many accountants do consider it "immutable law." They routinely talk of anything above a one-times-gross price as a premium and anything less as a discount! We accept this mindset, using it to our advantage when possible and working to overcome it on other occasions.

This ubiquitous mantra implies that accountants value practices with reference to annual gross revenues. That actually is a bit strange. Almost all other small businesses are valued based on a multiple of net cash flow to the owner (including salary, payroll taxes, benefits, profits, etc.). This is commonly called discretionary cash flow. For all small businesses in North America, that multiple is about 2.4 times cash flow to owner. The multiple for service businesses is less, more like 1.5 to 2 times. Therefore, if accountants were like everyone else, they would value their businesses at 1.5 to 2 times this discretionary cash flow. But they are different. Sometimes, where the cash flow is high for example, this mindset hurts the value of a business. At other times, like when cash flow is low, it helps the value.

Be aware that, despite our beliefs, not all practices sell at one times gross. One can no more say that than to say houses sell for $X per square foot. Some do and some don't. A whole host of factors will make a practice sell for more or less than another one. They include location, cash flow, type, size, etc. (See "Key Factors in Practice Value" at https://bit.ly/PracticeValue.) One times gross is the starting point because that is what everyone thinks. But it is probably better to think in terms of a range like 80% to 120% of gross as more realistic. Sellers and buyers need to move away from the mindset that every practice is the same and is valued the same. No one believes that each accounting or tax firm is a cookie cutter image of the one down the street. Of course, knowledge of those factors is a major reason for sellers and buyers to consider using an experienced broker who specializes in tax and accounting practices.

It is also important to note the distinction of what some mean by "practice multiple." There is 100% and there is 100%. No buyer or seller thinks 100% cash at closing is the same as 20% down and 20% a year for four years. Rarely will the latter result in the same amount in the pocket of the seller as would have happened with the first scenario. And yet, parties often talk about 100% of gross or one times gross without knowing what the other has in mind. Deals have failed at the signing table when it was discovered that the buyer meant one thing and the seller the other. Terms must be understood early in the process. (See "Show Me the Money: How Accounting & Tax Practices Are Sold" at https://bit.ly/APS-ShowMe for a discussion of terms.)

Another problem is deciding what is included in the gross revenue calculation. First, what is being considered: billings or collections? It is a given that accountants should understand the difference in accrual and cash basis accounting better than anyone, but when it comes to buying or selling a practice that is often ignored. Cash basis is often used but accrual can sometimes be a better indicator. At any rate, buyer and seller need to understand what is being presented. Second, what time period is considered in the calculation? There certainly does not seem to be a consensus. Is the last calendar year the determinant? Or do the parties use the most recent 12-month period? Does one look at an average of the last three or so years? Or does the year after the sale become the period under consideration? All those measurements are used by one party or the other and often without prior discussion. That can lead to problems. One cannot begin to discuss 100% of gross as a value without knowing what gross is.

To peg value at a multiple of gross, it is necessary to know what exactly is considered as a part of the sale. Are furniture and equipment included or are these added to the one times gross? What about accounts receivable, accounts payable, or work in process? The assets sold in the sale of an accounting practice are those necessary for the new owner to continue operating the business. Generally, this is the goodwill of the practice including client files, client lists, and non-compete agreements as well as property assets like furniture, equipment, and software. The truth of the matter is that used furniture and equipment are not considered to have much value; in fact, some buyers do not even want them. They rarely affect the overall value. Usually, the seller retains cash and accounts receivable while work in process is often prorated. The seller usually is responsible for all existing debt at the time of the sale. Leases are another item that needs to be discussed upfront.

While one times gross is not a law, it is certainly still very prevalent in the thinking of both sellers and buyers and cannot be dismissed. It is a general guideline and nothing more. It is best to realize, however, that prices do vary up and down from this simplistic standard. It is also best to remember simple economics, as follows:

1. Value is set by the buyer; sellers and brokers can determine an asking price but not the final value. If there are no buyers, the practice is worth nothing.
2. In an efficient market, quality will command a higher price. Dogs are hard to sell no matter what the gross.
3. The larger the pool of buyers, the greater the demand and, consequently, the greater the value.

Buyers and sellers will most likely get the best and fairest deals if they consider these principles. Sellers should realize the importance of a good broker who understands these principles, can use them to maximum value, and can create the best results. ◀

If you're searching for assistance in valuation, negotiations, and finding the right buyer, Accounting Practice Sales is a global leader in marketing tax and accounting firms. Contact Trent Holmes at Accounting Practice Sales at (800) 397-0249 or trent@aps.net.

EVERYTHING YOU NEED TO KNOW ABOUT

THE CORPORATE TRANSPARENCY ACT

BY ADAM M. RIPP & TRISTIN S. TAYLOR, BAIRD HOLM LLP

THE CORPORATE TRANSPARENCY ACT (CTA)[1] IS landmark legislation that will significantly impact how privately held corporations, LLCs, and other entities report ownership information to the federal government. For decades, anonymous shell companies with hidden ownership have enabled financial crimes like money laundering, tax evasion, and terror financing. In response, Congress enacted the CTA in 2021 as part of the Anti-Money Laundering Act of 2020 in the National Defense Authorization Act for Fiscal Year 2021.

This sweeping legislation creates new federal reporting requirements for certain business entities to (i) report certain beneficial ownership information (BOI) to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) and (ii) disclose information about who created the entity or registered it to do business in the U.S.

It is essential for all business advisors to understand these new reporting requirements so they can help their clients comply. This article provides an overview of key provisions, implementation timelines, and implications that business advisors and their clients need to understand.

Who (Must Report)?

The CTA mandates reporting for entities labeled as "reporting companies," unless they are exempt. "Reporting companies" include corporations, LLCs, LLPs, and other entities created by filing official documents with a secretary of state or similar office.[2] The CTA places the reporting obligation on reporting companies, as opposed to on the beneficial owners directly.[3]

The CTA exempts 23 types of entities from its reporting requirements, which broadly encompass entities that are already highly regulated (e.g., publicly traded companies, banks and other financial institutions, registered investment companies and investment advisers, insurance companies, and specified tax-exempt entities).[4] Large, U.S.-based operating companies (i.e., greater than 20 full-time employees and greater than $5 million in gross receipts or sales and physical presence in the U.S.) and inactive entities are also exempt; somewhat counterintuitively, there is no exemption for small companies.

What (Must Be Disclosed)?

Each reporting company that was formed prior to Jan. 1, 2024 (the Effective Date), must provide information regarding itself and its "beneficial owners."[5] Reporting companies formed on or after the Effective Date must also provide information regarding their "company applicants." A "beneficial owner" is any individual who either (i) owns or controls at least 25% of the equity interests (including convertible instruments and options) in the reporting company or (ii) exercises substantial control over the reporting company (including senior officers).[6] A "company applicant" includes both (i) the individual who directly files the document that forms or registers the reporting company and (ii) if more than one individual was involved in such filing, the individual primarily responsible for directing or controlling the filing.[7]

A reporting company must disclose the following information regarding itself and its business operations:[8]

- Full legal name;
- Any trade names or "doing business as" (DBA) name it operates under;
- Current address;[9]
- Jurisdiction of formation or registration; and
- Tax Identification Number (TIN) or Employer Identification Number (EIN).

A reporting company must disclose the following information regarding its beneficial owners and (if formed or registered after the Effective Date) its company applicants:[10]

- Full name;
- Date of birth;
- Current residential address (except a company applicant that is engaged in the business of forming entities can list its business address);
- A unique identification number from a non-expired identification document (i.e., a state-issued driver's license, U.S. passport, a state or local government ID, Indian tribal document, or a foreign passport if no other identification document is available); and
- An image of the identification document supplying the unique identification number.

Although FinCEN is still developing the secure, electronic filing system for BOI reporting (referred to as "BOSS" and further described below) and the final form of the BOI report is not yet available, FinCEN has made a draft version of the form available as part of the notice-and-comment process.[11]

When (Must It Be Reported)?

The CTA's filing deadlines depend on whether the reporting company was already formed or registered prior to the Effective Date.[12] Reporting companies formed or registered before the Effective Date have until Jan. 1, 2025, to submit their initial BOI report. Reporting companies created on or after the Effective Date, must do so within 30 days of its formation or registration (under FinCEN's current final rule, which may be amended; see below). Exempt entities that subsequently lose their exempt status must submit their initial BOI report within 30 days after loss of exemption.

On Sept. 28, 2023, FinCEN published a Notice of Proposed Rulemaking that, if finalized, would amend its current final rule to extend the reporting deadline for reporting companies formed or registered in 2024.[13] Specifically, reporting companies formed or registered in 2024 would have 90 days (instead of 30 days) to submit their initial BOI reports. Reporting companies formed or registered on and after Jan. 1, 2025, would still be subject to the 30-day reporting deadline. FinCEN cited "the novelty of the BOI reporting requirement" and the benefit of giving reporting companies more time to understand their obligations and collect information as its rationale for proposing the extension.[14]

While the current Effective Date is Jan. 1, 2024, it would not be surprising if FinCEN seeks additional time and funding to implement the CTA, beyond the proposed extended reporting deadline just described. Further, during the summer, both houses of the U.S. Congress introduced (but have not passed) bills to delay the Effective Date.

In addition to the initial reporting requirements just described, reporting companies must continuously update or correct their BOI reports within 30 days of any change in the reported information—such changes to the company's name, address or home jurisdiction, and changes to beneficial ownership upon a transfer, issuance, or the death of a beneficial owner.[15] There is no materiality threshold for reporting changes; therefore, all changes require an updated BOI report.[16]

If a reporting company knows of or suspects inaccuracies in its BOI report, it is obliged to file a correct report within 30 days.[17] A "safe harbor" provision exempts reporting companies from liability for misinformation if a corrected report is filed within 90 days of the erroneous report.

As mentioned above, FinCEN is still developing the electronic filing system that reporting companies will use to submit their BOI reports. FinCEN does not currently plan to accept BOI reports prior to the Effective Date.[18]

Where (Does the Reported Information Go)?

FinCEN will securely warehouse BOI reported under the CTA in a nonpublic database known as the Beneficial Ownership Secure System (BOSS).[19] Access to this data will be strictly controlled and granted on a case-by-case basis (other than authorized officers and employees of the Department of the Treasury, who will have unique access to BOSS to carry out their duties and for tax administration purposes).[20]

Federal agencies may access this data for matters involving national security, intelligence, or law enforcement. Similarly, state and local law enforcement agencies may access this information via court

CONTINUED ON PAGE 14

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authorization as part of a criminal or civil investigation. Additionally, financial institutions, with reporting company consent, may be able to access the database for customer due diligence requirements under the law. Federal and state regulators may also access BOSS for compliance and administration purposes.

FinCEN has engaged in a separate rulemaking process and issued a proposed rule that would regulate who has access rights to BOSS and under what circumstances, and outline data security protocols to safeguard BOI reported under the CTA.[21] Although comments on the proposed rule were due by Feb. 14, 2023, FinCEN has not yet issued a final rule.

Penalties

Failure to report carries civil and criminal penalties.[22] Willful non-reporting can result in a fine of up to $500 per day (capped at $10,000) and up to two years imprisonment. Knowingly disclosing BOI is subject to even more draconian penalties (i.e., $500 per day, capped at $250,000, and up to 5 years imprisonment). Failure by reporting companies to disclose correct information can also be penalized, and this can extend to individuals who influence the reporting company not to report, as well as senior officers of the reporting company in charge at the time of non-compliance. As mentioned above, the CTA has a safe harbor provision for reporting companies that voluntarily rectify inaccuracies in submitted BOI reports within 30 days of detection and no more than 90 days after submission of the report.[23] However, this safe harbor does not cover any inaccuracies corrected after 90 days, deliberate evasion attempts, or known inaccuracies at the time of submission.

Implications for Reporting Companies & Their Advisors

To comply, reporting companies will need to implement policy, process, and system changes to collect and report BOI. They must properly identify beneficial owners and company applicants and maintain up-to-date identification documentation. Reporting companies with frequent ownership changes will need to be especially prudent with monitoring and reporting. Additional compliance costs and burdens, including employee training on CTA duties and retention of third-party providers, likely will be incurred.

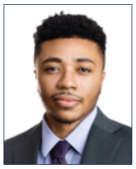
Advisors, like attorneys and accountants, hold an integral role in assisting reporting companies with adhering to CTA reporting rules and timelines. Key responsibilities may include:

- Identifying which clients are subject to CTA reporting requirements based on formation or registration date, ownership structure, and eligibility for exemptions;
- Informing clients of new reporting requirements under the CTA and timelines for compliance (i.e., explaining the breadth of the definition of "beneficial owners");
- Assisting clients with gathering necessary information on all beneficial owners ahead of reporting deadlines and maintaining documentation to demonstrate compliance;
- Staying updated on reporting requirements as FinCEN releases additional guidance;
- Recommending that clients establish processes to collect ownership details for future reporting needs; and
- Encouraging clients to reach out to you or legal advisors with any questions or need for advice on reporting procedures.

Conclusion

While certain regulations and an electronic filing system are still forthcoming, advisors and businesses need to understand the key provisions, timelines, and implications of this far-reaching legislation.

The CTA ushers in a new era of federal beneficial ownership reporting that will impact nearly all privately held entities. Accountants and other advisors will be at the forefront of the compliance effort, helping businesses grasp and align their practices with these new transparency rules. With the right preparation and guidance, advisors can help clients successfully navigate these rapidly developing rules and avoid any penalties for non-reporting. Through diligent observance of the CTA requirements, they can bolster legal protections and the financial integrity of their business clients. Furthermore, by partnering with their clients in compliance, advisors contribute to reinforcing financial transparency and security across the U.S. business ecosystem.




Tristin S. Taylor is an associate at Baird Holm LLP. Taylor's practice focuses on corporate transactions and general corporate matters. He counsels businesses of all sizes on a variety of matters, including entity formation, corporate governance, strategic transactions, and regulatory compliance. Adam M. Ripp is also an associate at Baird Holm LLP, representing businesses of all sizes on a variety of corporate transactions and general corporate matters. His practice focuses on strategic merger, acquisition, and divestiture transactions, as well as regulatory compliance, particularly in the banking sector and regarding antitrust matters. Ripp also regularly advises clients in a variety of industries through the entity formation process, corporate reorganization and succession matters, contract negotiations and disputes, and corporate governance issues. For more information, contact Taylor at ttaylor@bairdholm.com or Ripp at aripp@bairdholm.com.

Endnotes

1 31 U.S.C. § 5336 (West 2023).

2 FinCEN has not specified all types of entities that might be considered reporting companies, but it expects that the term will be interpreted broadly and include limited liability partnerships, statutory business trusts and most limited partnerships, as formation of those entities generally requires a filing with a secretary of state. However, entities such as sole proprietorships and certain partnership and trusts may not fall within this category.

3 31 U.S.C. § 5336(b)(1)(A).

4 31 C.F.R. § 1010.380(c)(2) (West 2023). Note that, as currently written, the CTA provides limited relief for tax-exempt entities, with exemptions specifically applying only to (i) nonprofit organizations described in Section 501(c) of the Internal Revenue Code (IRC) and exempt under IRC Section 501(a), (ii) tax-exempt political organizations described in IRC Section 527(e)(1) and exempt under IRC Section 527(a), and (iii) charitable and split-interest trusts described in IRC Section 4947(a). Id.

5 31 C.F.R. § 1010.380(b).

6 31 C.F.R. § 1010.380(d). Frequently Asked Questions, Fin. Crimes Enforcement Network (Sept. 29, 2023), Questions D.2 & D.4, https://www.fincen.gov/boi-faqs.

7 31 C.F.R. § 1010.380(e). No reporting company will have more than two company applicants. Frequently Asked Questions, supra note 6, Question E.1.

8 31 C.F.R. § 1010.380(b).

9 The reporting company's address must reflect either its main business location in the U.S, if applicable, or its primary U.S business site. Using a P.O. box or addresses of corporate agents or third parties is prohibited.

10 31 C.F.R. § 1010.380(b).

11 Agency Information Collection Activities; Proposed Collection; Comment Request; Beneficial Ownership Information Reports, 88 Fed. Reg. 2,760 (Mar. 20, 2023); Frequently Asked Questions, supra note 6, Question B.5. The comment period for the proposed action has closed.

12 31 C.F.R. § 1010.380(a)(1).

13 Beneficial Ownership Information Reporting Deadline Extension for Reporting Companies Created or Registered in 2024, 88 Fed. Reg. 66,730 (Sept. 28, 2023). The comment period for the proposed action closes on October 30, 2023. One day later, on September 29, 2023, FinCEN published two 30-day notices seeking comment (1) on the mechanism that FinCEN intends to use to collect beneficial ownership information from reporting companies and (2) on the application that FinCEN intends to require individuals to use to obtain a FinCEN identifier (which identifier is voluntary). Agency Information Collection Activities; Submission for OMB Review; Comment Request; Beneficial Ownership Information Reports, 88 Fed. Reg. 67,443 (Sept. 29, 2023); Agency Information Collection Activities; Submission for OMB Review; Comment Request; Individual FinCEN Identifier Application, 88 Fed. Reg. 67,449 (Sept. 29, 2023). The comment period for these notices closes on October 30, 2023.

14 Id. at 66,731.

15 31 C.F.R. § 1010.380(a)(2).

16 Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59,498, 59,524 (Sept. 30, 2022). No updated report is required for termination or dissolution of a reporting company. Id. at 59,514.

17 31 C.F.R. § 1010.380(a)(3).

18 Frequently Asked Questions, supra note 6, Question B.1.

19 Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. at 59,508–09.

20 31 U.S.C. § 5336(c)(2)(B), (c)(5).

21 Beneficial Ownership Information Access and Safeguards, and Use of FinCEN Identifiers for Entities, 87 Fed. Reg. 77,404 (Dec. 16, 2022).

22 31 U.S.C. § 5336(h); 31 C.F.R. § 1010.380(g).

23 31 U.S.C. § 5336(h)(C)(i); 31 C.F.R. § 1010.380(a)(3).

IRS INTENSIFIES EFFORTS TO COMBAT ERC SCAMS

CONSIDER GETTING A "SECOND OPINION"

BY RICK MEYER, CPA, MBA, MST, ALLIANTGROUP

THE IRS LAST FALL ISSUED IR-2022-183 WARNING AGAINST third parties improperly computing the Employee Retention Credit (ERC).[1] Then, the IRS issued a "renewed warning" in IR-2023-40 warning about promoters who aggressively mislead people and businesses into thinking they can claim these credits.[2]

The IRS took a bigger step this fall. On Sept. 14, 2023, the IRS issued IR-2023-169 with a moratorium on processing new ERC claims through at least the end of the year.[3] All of this said, ERC qualifications have not changed, and you can still file.

In fact, the IRS is still encouraging businesses to file legitimate claims, but the agency is asking businesses to review their claims with a trusted tax professional who actually understands the complex ERC rules, not a promoter or marketer trying to make a quick buck.

This is being done so that the IRS can combat the "fly by night" providers and it will allow the IRS to:

1. Add more safeguards to prevent future abuse;
2. Protect businesses from predatory tactics; and
3. Allow time for the IRS to work with the Justice Department to combat aggressive marketing and incorrect ERC claims.

If you hadn't heeded the warnings before, take the IRS' latest release as a sign that it's time to get serious. CPAs have a professional responsibility when they sign a return and that includes performing due diligence on third parties that are providing credit numbers.

ERC Horror Stories

Many promoters that sprung up during the pandemic are doing an ERC evaluation in minutes and claiming quarters without substantiation. Let's look at a few actual case studies we have had from wary CPAs asking us for guidance before they signed their name on an amended return reflecting a large refund.

COMMERCIAL RETAILER

This case involves a commercial retailer specializing in home goods. After responding to a brief questionnaire followed by a short phone call with an ERC provider, the retailer was told it qualified for all quarters in 2021 and that the business was entitled to more than $1MM in credits. Excited by the potential windfall, the retailer entered into an agreement with the ERC provider and excitedly called his CPA to give him the news.

The CPA was immediately skeptical about how little time and effort it took to make this determination. He knew it should take some time to properly conduct an ERC study. On top of that, the CPA also knew that few ERC claimants receive the max of $26,000 per employee. So, the CPA sought a "second opinion" on the original provider's claim, with an examination of the following:

- **Gross receipts?** The retailer had no significant decline in gross receipts.
- **Qualifying quarters?** The retailer was located in two states where government orders did not extend into the third quarter of 2021, yet the ERC provider used Q3 in their calculation. Furthermore, the client had stated that any restrictions had ended in May 2021.
- **Supply chain?** There was no reference to the location of the retailer's suppliers to substantiate any supply chain disruption, but the ERC provider claimed it under the partial suspension test.
- **Qualifying mandates?** There was no identification of any specific government order applicable to the retailer.
- **More than nominal impact?** The retailer estimated the impact in delayed work was 10% but the estimate was not substantiated.
- **Substantiation and documentation?** None of the information in the questionnaire completed by the retailer was substantiated by the ERC provider.

Thus, a $1MM credit did not exist. In this particular case, we engaged an outside law firm that was able to break the contract with the ERC provider so that the retailer would not be on the hook for more than $250,000 in fees. They have now engaged us to conduct a new ERC study.

TOOL MANUFACTURER

This case involves a tool manufacturer based in a rural area. After a few short phone calls with an ERC provider, the manufacturer was informed it qualified for an ERC claim amounting to more than $750,000 based on canceled trade shows. The manufacturer signed an agreement with that ERC provider based on the estimate, then contacted their CPA about the windfall.

The CPA expressed skepticism immediately, concerned about the lack of evidence to substantiate a claim that large. He also knew that the manufacturer had not experienced a decline in revenue through the pandemic, raising further alarm. The CPA contacted alliantgroup for a second opinion to determine if this claim would stand up to scrutiny. Our analysis:

- **Gross receipts?** There was no significant decline in gross receipts.
- **Qualifying business disruption?** There was no evidence showing the trade shows were cancelled due to government orders, nor that the trade shows were cancelled generally.
- **More than nominal impact?** The analysis did not show a nexus between the closure of trade shows, nor the manufacturer's supply chain issues and the manufacturer's more than nominal impact.
- **Qualifying mandates?** The government order referenced was simply the emergency declaration, not a specific government order applicable to the manufacturer's suppliers.
- **Substantiation and documentation?** The analysis stated that the manufacturer had to wait longer for materials but made no mention as to how long or how much longer they had to wait in comparison to 2019.

After a review of the ERC study and related documentation, we informed the manufacturer that the ERC study would not withstand IRS scrutiny in the event of an audit. As a result, we advised the manufacturer not to file the claim. They were able to disengage the ERC provider and legal action was taken to obtain a refund of the manufacturer's down payment. Again, the manufacturer subsequently came to us to perform a new ERC study.

Moral of the Story

When it comes to the ERC, it's the Wild, Wild West. The smell of gold (fast, easy fees) has lured these "pop-up" ERC providers to promise the world without doing the necessary and meticulous research and documentation to properly qualify and quantify a company for ERC.

The CPA may be stuck in the middle between a drooling client hungry for cash and the responsibility to perform due diligence before preparing and signing that tax return proposing a huge refund.

These cases exemplify the importance of consistently exercising one of our great CPA traits: "professional skepticism." In doing so, along with thorough due diligence, we are able to ensure that our clients receive both the best answer and the most appropriate solutions for their specific situations.

Unless you have absolute comfort with your client's ERC provider, a legal "second opinion" may be in order.

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1 *Internal Revenue Service. "Employers warned to beware of third parties promoting improper Employee Retention Credit claims." IR-2022-183. Oct. 19, 2022. https://www.irs.gov/newsroom/employers-warned-to-beware-of-third-parties-promoting-improper-employee-retention-credit-claims.*

2 *Internal Revenue Service. "IRS issues renewed warning on Employee Retention Credit claims; false claims generate compliance risk for people and businesses claiming credit improperly." IR-2023-40. March 7, 2023. https://www.irs.gov/newsroom/irs-issues-renewed-warning-on-employee-retention-credit-claims-false-claims-generate-compliance-risk-for-people-and-businesses-claiming-credit-improperly.*

3 *Internal Revenue Service. "To protect taxpayers from scams, IRS orders immediate stop to new Employee Retention Credit processing amid surge of questionable claims; concerns from tax pros." IR-2023-169. Sept. 14, 2023. https://www.irs.gov/newsroom/to-protect-taxpayers-from-scams-irs-orders-immediate-stop-to-new-employee-retention-credit-processing-amid-surge-of-questionable-claims-concerns-from-tax-pros.*

STATE TAX BRIEFING

THE COMING EPIC DISASTER

WHAT'S IN STORE IF THE EPIC OPTION BECOMES THE LAW

BY NICK NIEMANN & MATT OTTEMANN, MCGRATH NORTH LAW FIRM

IN THE 1980 POPEYE MOVIE STARRING ROBIN WILLIAMS AND Shelley Duvall, shortly after Popeye climbs out of his little boat onto the dock in the town of Sweethaven, he is immediately met by the Tax Man. After a brief introduction, the Tax Man promptly proceeds to impose a "docking tax" of 25 cents, a "new-in-town tax" of 17 cents, a "rowboat-under-the-wharf tax" of 45 cents, a "leaving-your-junk-lying-around-the-wharf tax" of $1, and a "question tax" of 5 cents.

If the new EPIC Option Consumption Tax initiative petitions get on the ballot, as expected, and are approved by Nebraskans in November, welcome to Nebraska's version of Sweethaven.

This article is offered as part of the ongoing debate about whether the EPIC Option is the right solution to Nebraska's tax burden.

What Is the EPIC Option?

The EPIC Option website describes what the EPIC Option is intended to do: "EPIC Option will **E**liminate all Nebraska **P**roperty, **I**ncome (/Inheritance), and **C**orporate taxes."

The EPIC Option website states that the EPIC Option will be achieved in two steps:

"Step 1: Vote of the people to amend the Nebraska State Constitution on the November 2024 Ballot."

"Step 2: Vote of the Legislature."

The EPIC Option consists of two separate petitions filed by their sponsors on Oct. 14, 2022. These are detailed below.

While the EPIC Option website describes in detail how the EPIC Option would be implemented, as well as the scope and proposed tax rate, this is all pursuant to legislation that, while already proposed, would apparently not be fully debated, designed, drafted, and approved by the Nebraska Legislature until after Nebraska's voters approve the EPIC Option Nebraska Constitutional Amendments. (See pending LB 79 at https://nebraskalegislature.gov/bills/view_bill.php?DocumentID=50183.)

In addition, since the EPIC Option is divided into two separate petitions, the possibilities are that neither is adopted, both are adopted, or one is adopted and one is rejected.

Scope of This Article

If either of the EPIC Option Constitutional Amendments is adopted, this would pose a variety of major impacts on every Nebraska citizen.

Such an analysis is beyond the scope of this one article. Other organizations have already provided, or are in the process of providing, a fiscal impact analysis. For example, the March 2, 2023, OpenSky Policy Institute "Policy Brief: Consumption Tax" concludes that if the EPIC Option is enacted as proposed in LB 79, it would result in a $7.4 billion annual tax revenue loss and a tax rate of 22.1% would be required for EPIC to be revenue neutral—that's nearly three times greater than what is proposed in the EPIC Option bill. (Read the full "Policy Brief" at www.openskypolicy.org/wp-content/uploads/2023/03/20230302ConsumptionTaxBrief.pdf.)

Instead, this article will focus on the legal issues and potential roadblocks posed by the brief, problematic language of the two EPIC Option initiative petitions.

What Does the EPIC Option Language Actually Mean?

As is often said, "The devil is in the details."

In drafting any type of document, whether it be a constitution, a statute, or a contract, balance is needed between succinctness and verbosity. The sponsors of the EPIC Option have chosen to be very succinct, replacing the several thousand words in the current Nebraska Constitution regarding taxation (see the Nebraska Constitution, Article VIII) with 82 words in the EPIC Option initiative petitions.

Below is the short version of our analysis of the succinct language in the EPIC Option initiative petitions. As fellow Nebraska residents, we submit this as to what might be considered by the proponents and opponents of the EPIC Option.

Review of Proposed Section 14

This is the first of the two petitions. It states:

> **"To add a new section 14 to Article VIII of the Nebraska State Constitution: VIII – 14 Notwithstanding any other provision of this Constitution, beginning January 1, 2026, no governmental entity in the State of Nebraska may impose taxes other than retail consumption taxes or excise taxes."**

Our comments on this new Section 14 include the following:

> **"Notwithstanding any other provision of this Constitution."** By stating that this new Section 14 applies "notwithstanding any other provision of this Constitution," this section now becomes, in effect, a super-section under the Nebraska Constitution. This is a common drafting provision when an overall superior provision is intended. By the nature of this statement, it would supersede all other sections of the Nebraska Constitution that exist not just with respect to taxation, but also with respect to any other constitutional provisions that may be built into other portions of the Nebraska Constitution that may get in its way.

"Beginning January 1, 2026." Prudently, the proponents have given the Nebraska Legislature the year 2025 to design, draft, and enact the legislation that would be needed to implement this section.

While this effective date provides enough time for the Legislature to act, it does not necessarily provide enough time for the highly likely court challenges to play out with regard to the EPIC Option itself or the implementing legislation. This could leave Nebraska in the position of having repealed all of its existing property, sales, income, inheritance, and other taxes while being left with an unenforceable or unconstitutional replacement under the EPIC Option. This would be an extreme, yet potential, result which would, of course, have disastrous effects on Nebraska (which can be discussed further elsewhere).

The Nebraska Supreme Court and Eighth Circuit Court of Appeals have demonstrated that they are fully willing to strike major Nebraska tax systems when the court finds them in violation of Nebraska or U.S. Constitution or federal statutory mandates. (See cases mentioned on the following pages.)

CONTINUED ON PAGE 20

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"No governmental entity in the State of Nebraska." Section 14 does not define what a "governmental entity" is, nor does it define what "in the State" actually means. While, generally speaking, the term "governmental entity" is capable of being reasonably interpreted by the Legislature, the term "in" poses an issue. For example, the question would be whether the state of Nebraska itself is considered to be "in" itself. If not, then this entire prohibition under Section 14 would not apply to the state of Nebraska. The result would be that the state of Nebraska may impose whatever taxes in whatever manner it may choose to impose, based on the pre-existing provisions of the Nebraska Constitution.

"May impose taxes." This does not prevent any governmental entity from imposing other types of charges, such as user fees (like some of the "taxes" in the Popeye movie). Since the term "taxes" is not defined by Section 14, it would be up to the Legislature to define this. However, the Legislature would not be free to define this term without regard to the commonly understood meaning of a "tax" as compared to a "user fee."

"Other than retail consumption taxes or excises taxes." This section does not define these terms. This is discussed next with regard to Section 15.

Review of Proposed Section 15

This is the second of the two petitions. It states:

"To add a new section 15 Article VIII of the Nebraska State Constitution: VIII – 15 Beginning January 1, 2026, the State of Nebraska shall impose a retail consumption tax or an excise tax on all new goods and services, and the Legislature may authorize political subdivisions to do the same. There shall be no exemptions from such taxes except for grocery items purchased for off-premises consumption."

Our comments on this new Section 15 include the following:

"The State of Nebraska shall impose." This is mandatory. It is not optional. Under this proposal, the state must do this (even if Section 14 does not apply to it). This is not self-executing. The Legislature and the Governor would presumably implement such a mandate.

"A retail consumption tax or an excise tax." This language contains both clarity and ambiguity.

Clearly, the word "retail" only refers to the "consumption tax" and not the "excise tax" because of the presence of the words "a" and "an," respectively, in front of each. The term "or" seems to say that the state has to make a choice. It appears that this choice must apply for "all" of the "new goods and services." In other words, could the Legislature choose to apply the state retail consumption tax on some new goods and services and the excise tax on other goods and services? Perhaps not.

Neither of these tax terms is defined. While the Nebraska Legislature would seek to include definitions within its legislation, that legislation would have limits based on the ordinary meaning of these words in the context of case law, which can be found in various cases throughout the country. (For some discussion of the meaning of these terms, see the Dec. 7, 2022, report from the Congressional Budget Office titled "Impose a Tax on Consumption" at www.cbo.gov/budget-options/58637.)

"On all new goods and services." Grammatically, there are no exceptions when the word "all" is used. Also, grammatically, the word "new" applies to both goods and services.

While the Legislature would need to define the terms "new," "goods," and "services," it would be limited to only taxing those that are considered "new" with respect to the ordinary meaning of this word.

"No exemptions from such taxes." No exemption means no exemption, meaning none. This seems pretty clear and is consistent with the requirement that the tax be imposed on "all," as stated above. Section 15 does allow an exemption for "grocery items purchased for off-premises consumption." This might be read to say that this is either an exemption the Legislature is authorized (but not required) to enact or this is a mandatory exemption the Legislature must enact.

In addition, the Section 15 drafters chose to use the term "grocery items" rather than the exemption utilized by Nebraska Statute which exempts "food." The common meaning of the term "grocery" is not limited to just food but instead includes food and other items or supplies that you purchase in a food or grocery store or supermarket (and the reference to off-premises "consumption" is the same word used in the permitted "consumption tax," so consumption here isn't limited to that which can be eaten).

EPIC Issues With the U.S. Constitution

All state tax systems need to run the gamut of, and comply with, the U.S. Constitution limits and prohibitions. These include the Import-Export Clause, the Commerce Clause, the Equal Protection Clause, the Due Process Clause, the Privileges and Immunity Clause, and the Supremacy Clause. Certain federal statutes also must be satisfied. This is an analysis for another day.

For some cases in Nebraska's history which show the willingness of the courts to apply these limits, see, for example, *Trailer Train v. Leuenberger*, 885 F. 2d 415 (8th Cir. 1988), *MAPCO Ammonia Pipeline v. State Bd. of Equalization & Assessment*, 238 Neb. 565 (Neb. S. Ct. 1991), *Kellogg Co. v. Herrington*, 216 Neb. 138 (Neb. S. Ct. 1984), *Natural Gas Pipeline Co. v. State Bd. of Equalization & Assessment*, 237 Neb. 357 (Neb. S. Ct. 1991), and *Jaksha v. State*, 241 Neb. 106 (Neb. S. Ct. 1992).

EPIC Issues With Its Own Language That the Legislature Cannot Fix

Because the EPIC Option would be part of the Nebraska Constitution, certain provisions, if problematic, cannot be fixed by the Legislature. In addition to the issues discussed above, some of these also include the following. (In this article, we are not addressing whether or how the pending LB 79 addresses these.)

> **The Scope.** Since Section 15 mandates the tax on "all new goods and services" (other than "grocery items"), the tax would apply to goods and services purchased by, as well as goods and services provided by, the private sector (companies and individuals), the U.S. government, the state of Nebraska, all Nebraska agencies and local governments, all churches, all nonprofits, all health care providers, etc. The North American Industry Classification System (NAICS) identifies several hundred types of services, which is a start on what would now need to be identified and taxed.
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> **Tax Rate Uniformity.** Section 15 says the state shall impose "a" retail consumption tax or "an" excise tax. It doesn't say plural taxes. This wording indicates a singular tax at one rate, which may prohibit using multiple rates of tax for different goods or services.

Or it might be construed that Section 15 does not specify that a single rate of "tax" must be imposed on the new goods and services. So, the Legislature might decide to enact a variety of rates, depending on the particular goods and services (which may be open to U.S. Constitutional challenge if Section 15 actually means only one uniform rate).

Lack of Tax Policy Options. Throughout the history of taxation, governments, for the welfare of their citizens, have sought to design their tax systems so that the brunt of taxation does not overly burden certain groups of people, certain types of organizations, or certain types of goods and services. Other than the "grocery items" exemption, and because of the apparent "one tax rate fits all," the EPIC Option will be one of the most regressive tax systems we've seen.

Lack of a Way to Compete. Like it or not, the state of Nebraska exists in an international business world built on competition. Often, in order to keep or attract companies, jobs, and talent in and to our state, the state needs to offer something in the form of tax exemptions or incentives in order to win. The EPIC Option ignores this reality and therefore reduces Nebraska's ability to compete.

Isolation. Companies and individuals face many state and local tax systems around the U.S. While these can be complex,

CONTINUED ON PAGE 22

CONTINUED FROM PAGE 21

they are generally workable because each state mainly has a combination of income, sales, and property taxes. This relative uniformity helps the national economy function with some degree of efficiency. The wholesale and complete swap of Nebraska's income, sales, and property tax system for an entirely new, unique, broad, and vague EPIC Option is highly likely to wreak havoc on the lives of Nebraska's citizens and companies (and cause Nebraska employers to just leave or not come).

Who Pays and on What Event. Section 15 says the state is to "impose" the stated tax "on" the stated goods and services, but it doesn't say who it is to be imposed on or what event (such as a sale or use or mere ownership) it is to be imposed on (unless one can conclude these answers are to be determined by the nature of the "retail consumption tax" or the "excise tax" itself).

What Is "New." Section 15 requires the taxation of all "new" goods and services. "New" is not defined. Generally, the word "new" refers to something recently made, grown, or built, or recently found, invented, or discovered. Just this concept alone will generate years of litigation to address, for example, when something is, isn't, or no longer is new.

An illustration would be an ongoing software license or real estate rental (which are either a good or service, "all" of which must be taxed if "new"). Those in effect at the effective date of EPIC would not be "new," so they should not be taxed. Likewise, the ongoing renewal of these would arguably not be "new" goods or services. So, this means much of the existing tax base would either disappear or never come into existence. This likely impacts the EPIC fiscal (and tax rate) assumptions. It also means a challenge under the U.S. Constitution Equal Protection Clause would be likely and possibly successful. (See cases cited above.)

Free Goods and Services. EPIC does not distinguish between services that impose a price or which are free. Instead, "all" "new" services must be taxed. The Legislature is not given the prerogative to tax some and not others. Typically, all tax laws will express the base on which the tax rate is to be applied and will also express the unit of measuring the base (i.e., the price paid for a sales tax). For those goods and services that are "free" (e.g., Google searches and various government services or charitable goods), the present Nebraska sales tax system would normally not impose a tax. However, under EPIC, Nebraska "shall impose" a tax on "all." So, to avoid such a nontax situation being considered a prohibited "exemption," the state of Nebraska will apparently need to come up with a system to determine the tax base (i.e., some artificial deemed price or value) on which the tax rate will now be imposed on this vast array of free services.

The History of Taxes

The EPIC sponsors chose their name well. We believe EPIC will become a disaster of truly epic proportions.

In Charles Adams' book "For Good and Evil: The Impact of Taxes on the Course of Civilization," the author offers several historical lessons on government taxation and spending. Near the end of his book, he leaves us with this observation:

> **"Taxes have often been the fuse that ignites the powder of human discontent, but once the explosion occurs, we seldom take notice of the fuse. Even with the civilizations lost from history, of which we know so little—if their silent temples and ruins could speak, what tax tales would they tell? The ancient Mayan civilization, according to one scholar, ended when taxpaying citizens simply disappeared into the jungle instead of paying taxes."**

The EPIC Option Destiny

The Tax Man in Popeye continued throughout the movie to impose various taxes on all kinds of things. He imposed a "bathtub tax," a "refrigerator tax," and a "household and appurtenances maintenance tax" on a family totaling $121,212.12. He imposed a "going-to-an-illegal-sporting-event tax" of 62 cents, an "up-to-no-good tax" of 50 cents, a "hamburger tax" of 5 cents, an "unlicensed-baby tax" of 89 cents, and an "embarrassing-the-tax-man tax" of one sunflower.

Ultimately, Popeye had had enough. When the Tax Man sought to impose on Popeye a "movin' in tax" of $5.25 and a "movin' out tax" of $4.25, Popeye pushed the Tax Man down a long loading shoot into the water, prompting a celebration by the townspeople.

The debate of the EPIC Option can be expected to become even more intense over the next few months, both within the Legislature (as state senators look to address various tax proposals) as well as in public forums, meeting places, and cafés across Nebraska.

Let's hope Nebraskans and our elected officials choose the right course in these major tax policy debates we now face. Let's not become Sweethaven and let's not prompt a response like that of the Mayans.

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401(k) PLAN AUDITS

COMMON ISSUES & RESOLUTIONS

BY PETER M. LANGDON, KOLEY JESSEN

AUDITS OF 401(K) PLANS ARE COMMON practice in the accounting profession, whether required for Form 5500 reporting purposes or completed on a voluntary basis. The Employee Retirement Income Security Act of 1974, as amended (ERISA), and the Internal Revenue Code of 1986, as amended (the Code) are the primary laws that govern 401(k) plans and under which most issues arise. A failure to identify and correct errors that arise in connection with a 401(k) plan audit risks exposing the plan to potential liability or disqualification. This article is intended to provide a brief overview of some of the more common issues that arise in auditing 401(k) plans, the rules that apply to those issues, as well as potential resolutions. The following overview is not intended as an exhaustive overview of the potential issues that can arise in connection with a 401(k) plan audit and professional advice should be consulted when issues do arise in auditing 401(k) plans.

Delinquent Remittance of Elective Deferrals

The U.S. Department of Labor (the Department) takes the position that a participant's elective deferrals must generally be remitted to the plan as soon as such amounts can reasonably be segregated from an employer's general assets, but in no event later than the 15th business day of the month following the month such amounts are withheld from an employee's wages or are received by the employer. Late remittance of elective deferrals may constitute an operational failure, which may disqualify the plan or lead to other potential liability exposure. The general rule of thumb is to remit elective deferrals in conjunction with the operation of an employer's payroll functions. Additionally, if elective deferrals are not remitted under the timeframe set forth by the Department, the elective deferrals could be characterized as plan assets, at which point the employer could arguably be engaged in a prohibited transaction.

To the extent an employer fails to timely remit an employee's elective deferrals, the employer can correct the error pursuant to the Employee Plans Compliance Resolution System (EPCRS). The applicable correction procedure would be for the employer to remit all late deferrals to the plan plus earnings. Under EPCRS, an employer may be eligible to self-correct the error or the employer may be required to complete a voluntary correction procedure (VCP) filing with the Internal Revenue Service (IRS), depending on the circumstances. To correct a prohibited transaction, the employer should proceed under the Department's Voluntary Fiduciary Correction Program (VFCP).

Discrimination/Compliance Testing Failures

Discrimination or compliance testing applies to all qualified plans to ensure plans do not discriminate in favor of (or excessively benefit) highly compensated employees. Typically, the plan's record keeper or third-party administrator will conduct annual non-discrimination testing for the plan. Generally, a plan must satisfy: (i) coverage testing under Code Section 410(b); (ii) the annual deferral percentage (ADP) test under Code Section 401(k)(3); (iii) the annual contribution percentage (ACP) test under Code Section 401(m)(2); (iv) the annual additions test under Code Section 415(c); (v) the annual deferral limit test under Code Section 402(g); and (vi) the top heavy test under Code Section 416. However, a safe harbor 401(k) plan is exempt from the ADP and ACP tests.

Specific correction procedures apply for each of the foregoing testing components and an evaluation of each of those procedures is outside the scope of this article. However, in general, compliance testing errors may be corrected under EPCRS and an employer should assess the extent of the errors to determine whether self-correction is available or whether a VCP must be filed. For example, failure to pass the ADP test is characterized as an operational failure under EPCRS and one self-correction method available to fix such an error would be to make a qualified non-elective contribution (QNEC) to non-highly compensated employees to raise the ADP to a level that would pass the ADP test.

Incorrect Application of the Definition of Compensation

The definition of compensation is an integral part of every plan. The definition of compensation is used for purposes of calculating deferrals, allocations, and testing, among other things. In addition, for testing purposes, the definition of compensation must comply with Section 415(c)(3) of the Code. Notably, a participant's compensation cannot exceed the limit set forth in Code Section 401(a)(17) ($330,000 for 2023) for any plan year in calculating deferrals and allocations. Typically, compensation will be defined as wages and salary, fees for professional services, commissions and tips, and bonuses. In certain situations, the plan sponsor may not use the appropriate definition of compensation in determining an employee's deferrals and allocations, which may give rise to excess deferrals/contributions or insufficient deferrals/contributions based on an employee's true compensation, as defined in the plan.

Failure to follow the plan's definition of compensation is an operational failure under EPCRS and, depending on the circumstances, the error may be self-corrected or the error may need to be fixed through a VCP filing with the IRS. As a general matter, however, the correction would be the same if self-corrected or through the VCP process. If an employee made excess elective deferrals,

a distribution should be made to the participant of the excess deferrals plus earnings. Also, matching contributions related to the excess deferrals (adjusted for earnings) should be forfeited and reallocated to other participants or to an unallocated account to offset future matching contributions. If an employee made deferrals that were less than what should have been made had the correct definition of compensation been used, the employee should receive a corrective QNEC in the appropriate amount. Also, the employee should receive a corrective employer-matching contribution, if applicable, in the appropriate amount.

Excess Deferrals/Allocations

The maximum amount that an employee may elect to defer into a qualified plan may not exceed the limit imposed under Code Section 402(g), which is $22,500 for 2023, without regard to any catch-up contributions. Also, the maximum total amount (including employee deferrals and employer contributions) that may be allocated to an employee's account cannot exceed the lesser of 100% of an employee's compensation (up to $330,000 in 2023) or the Code Section 415(c) limit ($66,000 in 2023). In the event an employee makes deferrals in excess of the Code Section 402(g) limit, the excess deferrals must be distributed to the employee by April 15 of the year following the year of deferral. If the excess deferrals are not distributed by the April 15 deadline, the plan will need to correct the error through the applicable procedure under EPCRS. To the extent an employee receives allocations (employee deferrals and employer contributions) in excess of the Code Section 415(c) annual additions limit, a general three-step correction procedure applies to correct the error, which is outlined under EPCRS.

Excess Participant Loans

Participant loans may or may not be allowed under a plan and plan sponsors should ensure their plan document allows participant loans before allowing an employee to borrow money from the plan. Participant loans must satisfy several rules under Code Section 72(p), among other rules, so the loan is not treated as a taxable distribution. For example, a loan generally cannot exceed 50% of an employee's vested account balance, up to a maximum of $50,000; provided, however, a loan of up to $10,000 is nontaxable even if the amount exceeds 50% of the employee's vested account balance, if permitted by the plan. In the event a plan loan exceeds the limitations under Code Section 72(p), the affected employee must repay the excess loan and, if needed, re-amortize the remaining principal balance over the loan's original amortization schedule. The foregoing is only one aspect of the rules under Code Section 72(p) and any excess plan loans should be more fully analyzed to ensure compliance with Code Section 72(p). The correction of excess participant loans is generally the same under self-correction and VCP, but the circumstances will dictate whether self-correction is available.

The foregoing represents only a few of the most common potential errors that could arise in connection with any 401(k) plan audit. Any professional reviewing a 401(k) plan's operations should understand all the potential issues that could impact the operation of the 401(k) plan. The use of a 401(k) plan audit is a useful tool used to identify and resolve any issues that do arise. ◀

Peter Langdon is an attorney in Koley Jessen's Employment and Benefits Department. With extensive experience advising clients on employee benefits, executive compensation, nonqualified deferred compensation, and general employment law matters, he is well-equipped to navigate the complex landscape of employee benefits. For further inquiries, contact Langdon at peter.langdon@koleyjessen.com.

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THE LANGUAGE OF GAAP

BY PAUL H. KOEHLER, CPA, GOVERNMENT & NONPROFIT SERVICES SPECIALIST

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) IS THE language of financial reporting that readers of financial statements rely on for clear communication of an entity's financial position and changes therein. Although GAAP includes many terms commonly used in the English language, GAAP also uses many critical terms specifically defined in GAAP literature. This report focuses on some of those critical terms that financial statement preparers and auditors need to understand to properly serve the public interest. Essentially, GAAP financial statements should use GAAP language: FASB GAAP for non-governments and GASB GAAP for state and local governments. We will emphasize FASB GAAP.

What's an Asset?

We've all probably heard entities claim that "our people are our most important asset." OK, but <u>people</u> are <u>not</u> reported as assets in GAAP financial statements. Additionally, Warren Buffett, chairman and CEO of Berkshire Hathaway, wrote the following in his February 2023 annual letter to the conglomerate's shareholders:

> "Though not recognized in our financial statements, this float* has been an extraordinary *asset* for Berkshire."
>
> **Float can be thought of as money available for use by an insurance company during the period between receipt of policyholder premiums and payment of policyholder claims.*
>
> Apparently, in this written assertion, Buffett is using a non-GAAP definition of an "asset" (or the implication would be that Berkshire's financial statements contain a material GAAP departure).

So, what is the GAAP definition of an asset? FASB Statement of Financial Accounting Concepts (SFAC) No. 8, Chapter 4, *Elements of Financial Statements*, paragraph E16 states: "An asset is a present right of an entity to an economic benefit." Chapter 4 goes on to elaborate many things about this definition, including that it means the "right" exists at the financial statement date and, therefore, has arisen from past transactions or other past events or circumstances (paragraph E28). In business entities, "economic benefits" generally result in potential net cash inflows. In not-for-profit (NFP) entities, "economic benefits" are used to provide desired or needed goods or services to beneficiaries or other constituents (paragraph E19).

Please note that while Concepts Statements are not considered part of *authoritative* GAAP, they are still part of GAAP, and per paragraph E2 of SFAC No. 8, Chapter 4, "definitions of elements of financial statements are a significant determinant of the content of financial statements." Why would any preparer or auditor *not* want to use them? As a reminder, FASB Concepts Statements apply to both business entities and not-for-profit entities (non-governments), <u>and</u> are a component of non-authoritative GAAP for state and local governments (GASB Statement No. 76, paragraph 7.) However, GASB Concepts Statement No. 4 defines the term "assets" for state and local governments as "resources with present service capacity that the government presently controls." Authoritative FASB GAAP definitions can be found in the master glossary (as well as the "20" sections) of the FASB Accounting Standards Codification (ASC). The term "asset" appears not to be among them.

An example of an item that would meet this FASB definition of an asset is an NFP's irrevocable beneficial interest in donated assets held by a third party, even if the third party had variance power that was unexercised at the financial statement date. In fact, an NFP with which I am familiar asserted this recognition was needed for fair presentation of their financial statements. I agree.

And, think about this: How can an auditor obtain sufficient appropriate audit evidence about the completeness assertion for assets presented on their client's financial statements without knowing the GAAP definition of an asset?

CONTINUED ON PAGE 28

CONTINUED FROM PAGE 27

What's a Liability?

A liability is a present obligation of an entity to transfer an economic benefit, per SFAC No. 8, Chapter 4, paragraph E37. A present obligation must exist at the financial statement date (paragraph E45). An obligation is any condition that binds an entity to some performance or action (paragraph E41). While most obligations are legally enforceable, including those arising from contracts, agreements (written or oral; paragraph E40), rules, and statutes, some liabilities rest on constructive obligations, such as through customary business practice (paragraphs E49 & E50). For example, constructive obligations may arise from an entity's historical policies and practices for sales returns as well as the absence of written warranties in business entities. On the other hand, donor-imposed restrictions on an NFP's use of contributed assets do not create obligations that qualify as liabilities (paragraph E53).

Please note that the GASB defines a liability as a present obligation to sacrifice resources that the government has little or no discretion to avoid.

Revenues, Expenses, Gains & Losses

Revenues and expenses result from delivering or producing goods, rendering services, or carrying out other activities.* Other activities include, for example, interest, rent, royalties, fees, and charitable contributions received and made (paragraph E84). Gains/losses are increases/decreases in equity except those that result from revenues/expenses (paragraphs E82 & E83).

**The FASB ASC Glossary at 610-20-20 adds the words "ongoing, major, or central operations."*

A term that still appears in some NFP financial statements is "support." This term was defined long ago (June 1993) in FASB Statements 116 on Contributions and 117 on NFP Financial Statements as referring to contributions. However, neither the FASB ASC nor SFAC No. 8, Chapter 4 appears to define the term "support." Thus, this term is apparently previous GAAP, and should probably not be used, especially when no contributions are received during the reporting period.

Events, Transactions & Circumstances

An event is a happening of consequence to an entity (internal or external). A transaction is a particular kind of external event; namely, it involves a transfer of something of value between two or more entities, either in an exchange or a nonreciprocal transfer. Circumstances are a condition or set of conditions that develop from an event or series of events. (SFAC No. 8, Chapter 4)

Based on these GAAP definitions the term "transaction" is clearly a conceptual subset of the term "event." Therefore, the phrase "transactions and events" would be inappropriate in a subsequent events footnote (it would be like referring to "cars and vehicles"). Reporting entity management could simply refer to "transactions and other events," or better yet just "events."

Accruals & Deferrals

Accrual accounting records the financial effects of events, transactions, and circumstances in the periods in which those items occur (SFAC No. 8, Chapter 4). This is not new! Nonetheless, numerous GAAP financial statements still contain footnotes stating: "The entity follows accrual accounting. Under accrual accounting, revenues are recognized when earned, and expenses when a liability has been incurred." Proper use of GAAP terminology would require replacing "earned" with "occurred," and "liability" with "cost."

Accrual is the accounting process of recognizing assets or liabilities and the related changes in revenues, expenses, gains, losses, or equity for amounts expected to be received or paid, usually in cash, in the future. In other words, transaction occurrence precedes the related cash flow. For example, if a lawn service mows my lawn with the understanding I will pay them later, I have an accrued liability.

Deferral, on the other hand, is concerned with past cash receipts and payments. Deferral is the accounting process of recognizing a liability resulting from a current receipt of cash or other asset, with deferred recognition of related revenues, expenses, gains, or losses. In other words, cash flow precedes related transaction occurrence (SFAC No. 8, Chapter 4). So, if I were to pay the lawn service to mow my lawn before they do it, then I would have a deferred charge on my balance sheet, probably reported as a prepaid expense. However, please be aware that GASB Concepts Statement (SGAC) No. 4 and GASB Statements 63 & 65 prohibit state and local governments from presenting deferrals as liabilities or assets; they are to be presented separately as "deferred inflows of resources" or "deferred outflows of resources," respectively.

Accrual/Deferral GAAP Departures to Avoid

- When a reporting entity enters into a contract to sell goods or services to a customer, but the contract is wholly unperformed as of the financial statement date, neither party has an accounting entry to make generally. The seller has no

asset yet, due to the absence of either performance or a cash receipt. The customer likewise has no asset or liability in the absence of their prepayment or seller performance. I have seen numerous real-life instances where entities have reported both assets and liabilities before any cash flows or performance have occurred, thereby overstating their GAAP balance sheets. (See *FASB ASU 2014-09 Revenue from Contracts with Customers* – Topic 606, paragraph BC 50.)

- When a seller bills a customer in advance of providing goods or services, no receivable is appropriate since no transaction has occurred (a billing is simply a demand for payment). Likewise, no deferred revenue liability is appropriate if no cash is received from the customer. The risk of this type of GAAP departure occurring increases if the entity's billing system is integrated with their general ledger. I've seen this happen, too.
- My largest first-year NFP audit client presented their G/L to me that included a balance sheet account in the millions of dollars (cannot remember if it was a debit or a credit) entitled "accrued deferrals." When I inquired as to the nature of this account and its substantial balance, I got no answer. This turned out to be one of several material prior-period adjustments I proposed, and the client made.

Selected Other Terms

- "Pledges receivable." I often see this term used by reporting entity management in their GAAP NFP financial statements. The word "pledge" is, of course, an English word with various meanings, such as:

  » The Pledge of Allegiance
  » A brand name of furniture polish

  But it is not a GAAP word. Neither the FASB ASC nor any FASB Concepts Statements I have found define it. In fact, the June 1993 Original FASB Statement No. 116 on Contributions says in paragraph 89: "This statement avoids the use of the term 'pledge' because it may be misinterpreted."

  Current authoritative GAAP (FASB ASC 958-310-25-1 and the Glossaries) define the terms "contributions receivable" and "promises receivable—two terms that are essentially interchangeable. Use those, not "pledge."

  A contribution is defined in FASB ASU 958-310-20 as "a transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner." A promise-to-give is a type of contribution. So remember, a contribution (received or made) can occur under GAAP even in the absence of a transfer of resources. Also, in GAAP, the words "contribution," "gift," and "donation" are synonymous substance terms and should not be confused with transaction forms such as "grant" or "award." Accounting and financial reporting are based on transaction substance, not form!

- "Earn" or "earnings." This term is not formally defined or discussed in SFAC No. 8, as it was previously in the now superseded SFAC No. 6, which associated that term with the excess of revenue over related expenses in exchange transactions, which conceptually involve a matching concept.

  More importantly, this term is neither defined nor used in the text of FASB ASU 2014-09, *Revenue from Contracts with Customers*. Exchange transaction revenues under GAAP are to be recognized upon satisfaction of performance obligations (not "earnings").

Conclusion

Financial statement preparers and auditors should become thoroughly familiar with the GAAP terms defined not only in authoritative GAAP pronouncements, but also in Concepts Statements as well. After all, these principles (GAAP) are represented by reporting entity management to have been followed, and auditors use them as criteria in their audits of GAAP financial statements. Any imprecision in the use of key terms can result in confusion and inconsistencies in both financial statement preparation and auditing, thereby failing to serve the public interest.

So, if you see or hear someone declare that, "for most people, their home is their biggest 'investment,'" you perhaps may be prompted to think, "OK, fine … but that ain't GAAP!"

Paul H. Koehler, CPA, is a sole practitioner in Lincoln, Neb. He has more than 45 years of experience in auditing, training, and consulting, specializing in nonprofit organizations and state and local governments. You may contact him at (402) 488-1578.

LEGACY GIVING

A CONVERSATION FULL OF OPPORTUNITY

BY CATHERINE FRENCH MCGILL, JD, CAP®, AEP®, GIFT ACCEPTANCE MANAGER, OMAHA COMMUNITY FOUNDATION

CHARITABLE GIVING IS AN IMPORTANT part of any estate planning conversation. Certainly, legacy-making plans are frequently in the news because of the high-profile people who establish them. Your clients may not realize that they, too, and nearly anyone, really, can leave a legacy to support their favorite charitable causes.

By discussing what legacy charitable gifts are, how they work, and then formalizing your clients' plans with the proper documentation, you can help your clients tie up a few of "life's loose ends" far in advance of when that legacy gift is actually made—and give your clients peace of mind knowing it will actually get done.

Clients' charitable giving intentions and the possibility of establishing legacy gifts should be a routine and standard topic of any financial or estate planning discussion, right alongside provisions in an estate plan for family and loved ones.

Here's a primer to help you simplify key principles when you discuss legacy giving with your clients:

WHAT IS A LEGACY GIFT?

Encourage your clients to think of leaving a charitable legacy as a post-life gift that the client structures in advance. Legacy gifts are often referred to as planned giving.

WHAT ASSETS CAN BE USED TO MAKE A LEGACY GIFT?

Like the gifts to nonprofit organizations that your clients are already making during their lifetimes, cash, stock, real estate, life insurance, an IRA beneficiary designation (which is extremely tax effective) are all examples of assets that can be used to make a legacy gift. The donation can be expressed in a client's estate planning documents as a dollar amount, percentage of the whole, or a gift of the assets themselves. Your client will want to choose assets carefully, enlisting your expertise to do so.

HOW IS A LEGACY GIFT ACTUALLY MADE?

To advisors, this is common sense. But do not overestimate your clients' understanding about estate plans and how they work. A surprising two out of three Americans have no estate planning documents!

HOW CAN A DISCUSSION ABOUT LEGACY GIFTS HELP MOTIVATE CLIENTS?

Estate planning can be an uncomfortable topic because, by definition, it requires a client to contemplate mortality. This is likely part of the reason that 40% of Americans say they won't even consider putting a will in place unless or until their life is in danger. Most clients think charitable giving, though, is a much more pleasant topic than discussing the end of their own lives. That's why legacy giving is a topic that can help break the ice and pave the way for the broader, essential conversation about overall estate planning.

WHAT ARE SOME PARTICULARS TO BE AWARE OF?

Most legacy gifts can be revoked or altered while the client is alive. This is an important feature to mention to clients who want to include charitable giving in their estate plans but like the idea of flexibility as the overall family and financial picture changes over the years.

WHAT TOOLS CAN A COMMUNITY FOUNDATION OFFER TO HELP?

A particularly useful technique for legacy giving is to have your clients establish a fund at a community foundation that spells out their wishes for charitable distributions upon death to specific organizations. The client's estate planning documents can, in turn, simply name the fund at the community foundation as the beneficiary of charitable bequests. The client can adjust the terms of the fund anytime during their lifetime to reflect evolving charitable priorities. ◀

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Catherine French McGill, JD, CAP®, AEP® is the gift acceptance manager at the Omaha Community Foundation. To learn how the Omaha Community Foundation can partner with you to help your clients with their legacy planning, call (402) 342-3458 or email giving@omahafoundation.org.

THE SIX-WORD Success Formula

FIND A NEED AND FILL IT

BY THE DAVENCHAR GROUP

AS A CPA, YOU LIKELY WON'T BE SURPRISED TO LEARN THAT 72% of small business owners refer to their CPA as their most valuable and trusted advisor. That's the good news.

However, 76% of small business owners also believe their CPA is only reactive to their business needs. The CPA uses a tax return to tell the business owner what has already happened. That's the bad news.

The reality is that small business owners want—and need—proactive guidance. A recent survey from CCH revealed (and supports the data above with a 1% variance) that clients are looking to their CPAs to provide the following services:

- Accounting and audit services (93% of clients)
- Added tax services (89% of clients)
- Advisory and consulting services (75% of clients)

Clearly, CPA firms are not utilizing their complete potential with respect to client service, especially when it comes to providing advisory services. This leads many clients to be specifically dissatisfied with their CPA firms, according to the Wasp Barcode survey, for the following reasons:

- No guidance or advice is offered
- No pro-activeness exists
- Lack of education for business owners

Clients do not want their CPA firms to simply handle numbers for them. Rather, they want them to help devise financial strategies that aid business growth and profitability.

Here's the thing, the need for qualified help with taxes will never go away—but the business itself sure can. Today, 64% of small business owners are worried that shaky economic conditions may contribute towards business closures, many of which can be mitigated by education and proactive planning.

The shift towards also offering advisory services allows CPAs to create greater value for their clients. By leveraging their expertise and deep understanding of financial data, accountants can identify opportunities for growth, cost savings, and profitability improvements. Through strategic planning and financial analysis, they can help clients make informed decisions that drive business success. By delivering tangible value and becoming integral partners in their clients' growth journeys, accountants can foster stronger client relationships and enhance overall satisfaction.

A lot of CPA firms think that they are doing this, but they are not.

In reviewing the advisory services menus of the average CPA firm, those services are fairly predictable. Not that they aren't necessary, just predictable. They include the initial proactive guidance needed in choosing a business entity, compliance, QuickBooks setup...the usual "now you're in business" services. Then there are the reactive services: compliance, payroll, bookkeeping, tax prep, audits, and consulting because there's an imminent problem.

However, remember that 75% of small business clients? The ones who are looking for proactive guidance to keep their businesses healthy and growing?

The dichotomy here is a glaring opportunity for savvy CPAs. And here's where the "find a need and fill it" success formula fits in. Small business owners want guidance. They trust their CPAs more than anyone else.

The future of accounting lies beyond the traditional realms of bookkeeping and compliance. As automation takes over routine tasks, accountants are presented with a unique opportunity to transition into trusted advisors. Embracing advisory services allows accountants to provide strategic insights, guidance and value-added solutions for their small business clients. By leveraging technology, adapting to evolving roles, and focusing on skill development, accountants can play a crucial role in shaping the financial success of their clients—and their own practices. ◀

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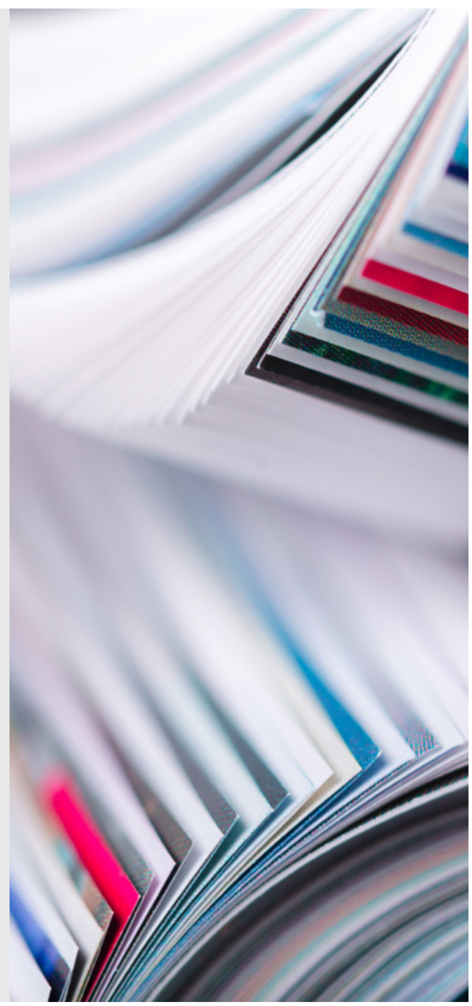

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