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Cuba, Now on the Right Side of the IRS!

Roman A. Basi, MBA/Attorney at Law
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In October of 1962 the United States was almost dragged into a nuclear war with Russia because of Cuba. In response to the failed Bay of Pigs Invasion and the presence of American ballistic missiles within range of Moscow, Cuba requested nuclear ballistic missiles from Russia and Mr. Khrushchev complied. Our then president, John Kennedy recognized the threat and ordered a blockade on the nation of Cuba. The situation escalated to the point where the President ordered the United States Army and Navy to prepare to invade Cuba and the Air Force to get ready to carry our first round of nuclear preemptive attacks against Russia. The consequences for this world would have been absolutely devastating had the go-ahead been given.

What followed was a continuing cold war between NATO nations and The Warsaw Pact until 1991.

Because of the incident, Cuba was given the cold shoulder by America for 25 years even after the Cold War ended. The United States was so mad in fact, that foreign earned income from Cuba was made taxable under Subpart F income, by putting them on the Section 901 list (concepts discussed below). That put them on the wrong side of the IRS.

What is Subpart F Income?

Generally, income of controlled foreign countries or CFC's is generally exempt from tax in the United States. Subpart F (Internal Revenue Code 952) was an attempt by Congress in 1962 to impose limits on deferral of foreign earned income. Within it, is Paragraph (a)(5) which includes into taxable United States income of which Section 901(j) applies.

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A CASE STUDY

Employee v. Contractor

In this Tax Court Case, there was the taxpayer and the IRS. The taxpayer was working for the federal Department of State under a personal service contract or PSC. The PSC clearly dictated essentially every detail of the work relationship. The relationship was such that the taxpayer showed up at a specific time, compensation, and guidelines for leave accrual and use.

The taxpayer was classified, by the Department of State as a contractor for federal tax purposes. In Tax Court and through pleadings the IRS asserted the taxpayer was an employee and should be classified as such. Looking at the elements on the terms of the PSC, every duty the taxpayer had was clearly outlined. The taxpayer made no opposite claim, other than to assert which elements were not met in order to be an employee rather than a contractor.

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IRC Section 952(a)(5) reads: the income of such corporation derived from any foreign country during any period during which section 901(j) applies to such foreign country. The payments referred to in paragraph (4) are payments which would be unlawful under the Foreign Corrupt Practices Act of 1977 if the payor were a United States person. For purposes of paragraph (5), the income described therein shall be reduced, under regulations prescribed by the Secretary, so as to take into account deductions (including taxes) properly allocable to such income.

And Code Section 901(j)(2)(A) reads: In general this subsection shall apply to any foreign country—

- (i) the government of which the United States does not recognize, unless such government is otherwise eligible to purchase defense articles or services under the Arms Export Control Act,
- (ii) with respect to which the United States has severed diplomatic relations,
- (iii) with respect to which the United States has not severed diplomatic relations but does not conduct such relations, or
- (iv) which the Secretary of State has, pursuant to section 6(j) of the Export Administration Act of 1979, as amended, designated as a foreign country which repeatedly provides support for acts of international terrorism.

Do you see the legal problem Cuba had with the IRS? There were only 5 countries on the Section 901 list as of December 31, 2015, which then included Cuba, Iran, North Korea, Sudan, and Syria (Internal Revenue Bulletin 2005-3). It had been over a half-century since the incident between once amicable neighbors.

Enter Revenue Ruling 2016-8.

In Revenue Ruling 2016-8, the IRS announced that Cuba is no longer one of the countries described in Section 901 of the Internal Revenue Code. It is retroactive to December 21, 2015. There are plenty of arguments, both for and against, thawing relations against Cuba. On the down side, a ruthless dictator is getting what he wants. On the up side America is safer and has another business partner in a close neighbor. The current Administration believes the adversity to the Cubans served neither nation.

Conclusion

Here at The Center we don't get into politics. What will happen next, is a matter for politicians to process, for people to ponder. We do valuations and business succession planning and we do both well. We do not endorse nor condemn this revenue ruling. We want business people to know, this is a big event in the business tax world and there is quite possibly a new haven for business in North America. This is opportunity for American business. They are now on the right side of the IRS.

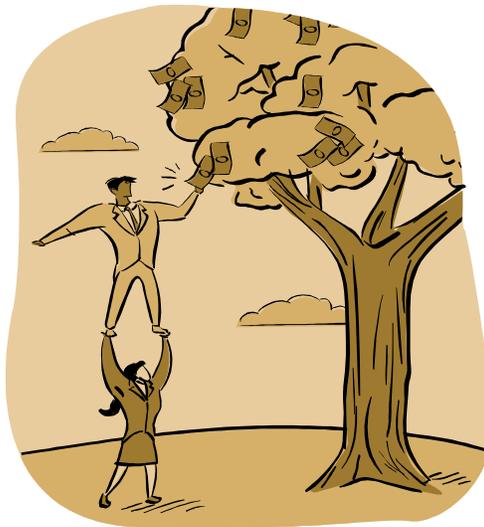


About the author:

Roman A. Basi, President of The Center, is an Attorney, Real Estate Broker, and Title Insurance Agent. Roman speaks and advises The Center's clientele on such matters as Business Law, Succession, Estate & Tax Planning and Real Estate.

Points of Interest

- **Because of the incident, Cuba was given the cold shoulder by America for 25 years even after the Cold War ended.**
- **... income from Cuba was made taxable under Subpart F income, by putting them on the Section 901 list. That put them on the wrong side of the IRS**
- **This is opportunity for American business.**



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A CASE STUDY CONTINUED:

The Court determined that the taxpayer was in fact, an employee due to the facts stated above regarding time, compensation and leave. The Court also pointed out that the taxpayer, now employee, did not work for anyone else and there was no risk in the relationship pointing to a more employee status as opposed to a contractor status. Penalties were not assessed for the three year period.

Editor's Comment: This is an interesting contractor v. employee case because it involves an institution of the federal government itself. That institution being the Department of State. It demonstrates that it is not only the private taxpayer / small business that is getting this classification wrong. I would recommend to anyone with independent contractors to review their situation and reclassify their workers if need be.



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What Is Your Game Plan for Retiring from Your Business?

In their book, *The \$10 Trillion Opportunity*, Richard Jackim and Peter Christman note that: "...Within the next 20 years, more than 90 million people in the US and Canada will be retiring. These are the "baby boomers," the generation born between 1946 and 1964...Baby boomers have been the most affluent and influential population group in the history of mankind, and now they're getting ready to retire."

Economist and demographic expert Robert Avery at Cornell University predicts baby boomers will transfer 10 trillion dollars to later generations -- the largest generational transfer of wealth in the history of humankind. The vast majority of this wealth is held as stock in more than 12 million privately owned businesses, and during the next 10 - 15 years, more than 70 percent of these companies are expected to change hands."

Yet, according to the authors, in spite of overwhelming evidence that exit planning is a vital part of business ownership, most business owners don't create an exit plan.

"Due to lack of good planning, only 30 percent of family-owned businesses survive through the second generation. A study of 300 former business owners who sold their companies within the last 12 months showed that 75 percent of the respondents felt the sale did not accomplish their personal or financial goals. These statistics suggest too few business owners are proactively planning for the inevitable exit process."

If you know of a business owner who's thinking of selling or buying a business and who might benefit from a **free, confidential**, consultation, have them contact me at mertel@lmaallc.com

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Frequently Asked Questions...



Q: I would like to file an amended return. Can I go back 8 years?

A: Generally a claim for a refund must be made within 3 years of its due date. However, we have amended returns 6 years ago, which did not call for a refund.

Q: What happens if I filed an extension three years ago?

A: Then the three year statute of limitations is potentially expanded to September 15 for the year in question. On the other hand if the return was filed July 1, that makes the amended tax return for refund due July 1 of the corresponding year.

Q: If I suffer someone has stolen from me, how long can I amend my return?

A: It's not an issue of how long back you can amend. It then becomes whether you can prove the loss and you would take the loss in the year it was discovered as well.

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