Texas Tax Lawyer

A Tax Journals

Spring 2017 • Vol. 44 • No. 3

TAX SECTION
STATE BAR OF TEXAS

www.texastaxsection.org

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- Tax Section Committee Chair and Vice Chair Roster

THANK YOU TO OUR SPONSORS!

Dear Fellow Tax Section Members:

We are nearing the end of our fiscal year! Having served as Chair, I understand fully why the Tax Section is considered one of the most active Sections of the State Bar. The Tax Section offers a series of programs, events, committees and publications for the benefit of its members, all of which converge to make the Tax Section an incredibly busy and productive Section. Here is a recap of a few recent and pending developments.

Tax Section Annual Meeting

The Tax Section Annual meeting is around the corner! It will be at the Hilton Anatole in Dallas, Texas on Friday, June 23, 2017. If you have not already registered, you can do so on our website at http://www.texastaxsection.org/Registration/Events.aspx?EventID=17. This is a great opportunity to network with other tax lawyers throughout the State of Texas and get caught up on the most recent developments in tax law. We will also have our legendary Tax Legends lunch which provides an interview with a tax legend. This year's interviewee will be John Porter with Baker Botts. We hope to see you at our Annual Meeting!

Committee on Governmental Submissions

The Committee on Governmental Submissions is on track to set yet another record this year with its governmental submissions. To date, the Committee has issued 15 comment projects with additional ones on the way. The State and Local Tax Committee has filed 12 of these and has additional projects in progress. In addition, the Partnership Tax and Tax Controversy Committees are working on comments to a set of partnership regulations previously issued by the IRS under the new partnership audit rules. While these regulations were previously withdrawn under the regulatory freeze announced by the new Presidential administration in January, the Council decided to proceed with completing a set of comments given the significance of the new law and the fact that the regulations will likely be re-issued in the near future.

Outstanding Texas Tax Lawyer

Each year the Tax Section issues the coveted Outstanding Texas Tax Lawyer Award to an attorney who exemplifies the virtues of an outstanding Texas tax lawyer. And each year, the Section is fortunate enough to have multiple qualified candidates to choose from. This year was certainly no exception. However, one individual stood out among the rest. William ("Bill") Elliott was nominated by his partner Kevin Thomason and was endorsed by several past-recipients of the Outstanding Texas Tax Lawyer award. He won the award this year by a landslide. We will be pleased to honor Bill with this award and to recognize his many accomplishments at the Awards Dinner on June 22, 2017 in Dallas, Texas. If you happen to see Bill in the meantime, please congratulate him on this prestigious award!

Scholarship Recipients

The Tax Section also issues several scholarships to deserving law students who are selected from among qualifying candidates. The deadline for submitting scholarships was April 7, 2017. The Law School Liaison Task Force received 26 applications from students at 11 law schools. Recipients of the scholarships will be recognized at the Awards Dinner on June 22, 2017.

Leadership Academy

One of the Tax Section's signature programs is its Leadership Academy. It is designed to assist and promote the next generation of leaders in the tax law profession. The last class graduated 20 participants in January 2017. Applications for the next class should be available later this calendar year.

In addition, the Tax Section recently completed a promotional video for the Leadership Academy program. The video is intended to provide prospective applicants with information about the program. The new video is available on our website and will be shown at our annual meeting on June 23rd.

Special Thanks!

As my tenure as Chair of the Tax Section comes to an end, I would like to pause for a moment to recognize and give special thanks to the many outstanding tax lawyers that make the Tax Section as great as it is. This includes the Officers, Council Members, Committee Chairs and Vice-Chairs, project leaders and everyone else involved with the Tax Section who continuously give their time, energy and resources to the various activities of the Tax Section. I would also like to give special thanks to Kelly Rorschach, our Section's Administrative Assistant for her excellent work and patience in getting me through my year as Chair. I look forward to recognizing several of the Tax Section's outstanding leaders at the Awards Dinner on June 22, 2017.

Join a Committee

We have an active set of committees, both substantive and procedural as in previous years. Our substantive committees include: Corporate Tax, Employee Benefits, Energy and Natural Resources, Estate and Gift Tax, General Tax Issues, International Tax, Partnership and Real Estate, Property Tax, Solo and Small Firm, State and Local Tax, Tax Controversy, Tax-Exempt Finance, and Tax-Exempt Organizations. In addition, our facilitator committees include: the Committee on Governmental Submissions, Annual Meeting Planning Committee, Continuing Legal Education Committee, Newsletter Committee, and Tax Law in a Day Committee.

Any members interested in joining a committee can do so by visiting our website at www.texastaxsection.org.

Contact Information

Below is my contact information as well as the contact information for our Tax Section Administrator, Kelly Rorschach, if anyone would like additional information:

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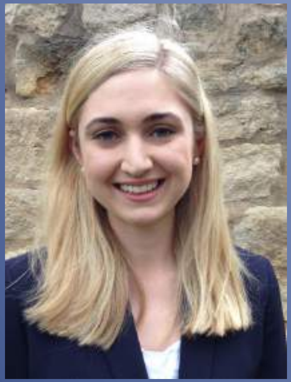
Congratulations!!

The following students will receive the Law Students Pursuing Tax Law Scholarship

- Emily Fawcett, The University of Texas School of Law
- Mary Sommers, Southern Methodist University Dedman School of Law
- Thomas Bettge, Pennsylvania State University, Dickinson Law
- Oscar Carrillo, Texas Southern University, Thurgood Marshall School of Law

2017 State Bar of Texas Tax Section Annual Meeting Agenda
June 22-23, 2017
Anatole Hotel | 2201 N. Stemmons Freeway | Dallas, TX 75207

THURSDAY, JUNE 22

5:00pm – 6:00pm **Complimentary Networking Reception**
Anatole Hotel-Milan Room

All Tax Section Members Welcome!

Even in today's age of email and conference calls, we still need opportunities to meet each other face-to-dace in order to develop relationships to help guide us through our careers

FRIDAY, JUNE 23

8:15 – 8:45 **Tax Section Membership Meeting**
Anatole Hotel-Monet Room
David Colmenero, Chair
Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP, Dallas, TX

Stephanie Schroepfer, Chair-Elect
Norton Rose Fulbright, Houston, TX

8:45 – 9:45 **Update From the Taxpayer Advocate** **CLE 1 hr.**

Nina Olson, Internal Revenue Service, Washington, D.C.
Ben Vesely, BDO USA LLP Dallas, TX

9:45 – 10:45 **International Returns for Foreign Trusts: Identifying & Planning Around Tax Traps** **CLE 1 hr.**

Kevin Leiske, Armbrust & Brown, PLLC, Austin, TX
John Strohmeyer, Crady, Jewett & McCulley, LLP, Houston, TX

10:45 – 11:45 **Property Tax Update** **CLE 1 hr.**

Ken Nolan, Dallas Central Appraisal District Chief Appraiser, Dallas, TX
Amy Stowe, The Law Offices of Amy Stowe, Dallas, TX

11:45 – 12:00	**Break/Buffet Lunch Service** *(Ticket Required)*	
12:00 – 1:00	**Lunch Presentation: Texas Tax Legends Interview:** ***Tax Section Former Chair, William D. Elliott, Continues His Texas Tax Legend Interviews with John Porter*** *(Ticket Required)* *John Porter, Baker Botts, LLP, Houston, TX* *William D. Elliott, Elliott, Thomason & Gibson, LLP, Dallas, TX*	**CLE 1 hr.**
1:00 – 2:00	**Estate Planning Under the New Administration and 2017** *Michelle Rosenblatt, Armbrust & Brown, PLLC, Austin, TX* *Eric Marchand, Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP, Dallas, TX* *Jim Roberts, Glast, Phillips & Murray, PC, Dallas, TX*	**CLE 1 hr.**
2:00 – 3:00	**State Tax Update** *Matt Larsen, Baker Botts, LLP, Dallas, TX* *Sam Megally, K & L Gates, LLP, Dallas, TX* *Sarah Pai, Texas Comptroller's Office, Austin, TX*	**CLE 1 hr.**
3:00 – 4:00	**Small Business M & A Issues/Hot Topics: Correcting Clients Past Misdeeds-Domestic Voluntary Disclosures and Correcting Worker Classification Issues** *Amy Stowe, The Law Offices of Amy Stowe, Dallas, TX* *Anthony Daddino, Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP, Dallas, TX*	**CLE 1.0 hr.** *Ethics-1.0*
4:00 – 5:00	**2017 Oil & Gas Tax Update** Todd Lowther, *Thompson & Knight, LLP,Houston, TX*	**CLE 1 hr.**

THE WILSON FIRM
TAX LAWYERS

An extension worth seven figures? For clients with undisclosed offshore accounts, filing an extension can be mean much more than simply buying time.

By: Lee Wilson, JD, LL.M.

With the recently passed tax filing deadline, many taxpayers and their CPAs are breathing a sigh of relief, finally free of the pressures and stress that tax season brings with it. But for some, there remains additional information necessary to complete their returns, and so millions of taxpayers have submitted Form 4868, which grants an automatic extension of the deadline to file the tax return for 6 months.[1] For taxpayers with foreign bank accounts and/or assets that have yet to be disclosed to the IRS — either with their tax returns and/or FBAR filings, or alternatively, through one of the IRS' current voluntary disclosure programs — filing the extension can prove much more valuable than simply allowing additional time.

For summary background purposes, under the multiple iterations of the Offshore Voluntary Disclosure Program ("OVDP") administered by the IRS' Criminal Investigation Division, U.S. taxpayers have had the opportunity to avoid the severe statutory civil and criminal penalties applicable to a failure to annually file the required FBAR form and report any associated income from such accounts since the original program was announced in March 2009. OVDP requires taxpayers to provide their previously-filed original (and if applicable, amended) tax returns,

[1] I.R.C. § 6081.

amended tax returns reporting any previously unreported foreign income over the preceding 8-year period, as well as FBARs for each account that the taxpayer(s) failed to disclose during that same period.[2] As part of the disclosure process, participants are required to remit any unpaid tax, along with the statutory interest required for late payment and a 20% accuracy-related penalty based on the delinquent tax liability.[3] Any late filing and late payment penalties are also required to be paid.[4] Further, participants are required to pay, in lieu of all other penalties that may otherwise apply, an Offshore Penalty equal to 27.5% of the highest aggregate balance of any undisclosed foreign accounts as well as the value of certain other foreign assets required to be disclosed during the period covered by the voluntary disclosure.[5]

A key consideration in evaluating any case involving undisclosed offshore accounts and offshore non-reporting of income is determining what constitutes “the period covered by the voluntary disclosure.”[6] The OVDP process itself is a purely administrative program in its origin, and thus, there is no statutory or regulatory authority to refer to when attempting to answer this question. Practitioners are instead required to look to a series of Frequently Asked Questions (“FAQ”) published by the IRS that lay out the requirements, procedures, and rules governing it.[7] Under FAQ 9 of the most recent version of FAQs published in 2014, the voluntary disclosure period is stated to include “the most recent eight tax years for which the due date has already passed.”[8] Such due date includes any proper extensions thereof.[9] Thus, participants who want to

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[2] Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers, https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised (last visited April 24, 2017).
[3] *See* I.R.C. § 6662(a).
[4] *See* I.R.C. § 6651.
[5] *See* Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers, FAQ 7.
[6] *See id.*
[7] *See supra*, n. 2.
[8] *See* Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers.
[9] *Id.*

come within OVDP's "protections" might have an some latitude to effectively elect the disclosure period that the past-due tax, tax penalties, and Offshore Penalty will apply to.

For a simple example, let's say Client A – a U.S. taxpayer and native Dutchman - has multiple foreign bank accounts in the Netherlands currently in excess of $6 million USD, and those accounts have been held by Client A for well over a decade. When asked why these accounts were never declared nor the income reported in previous years, Client A states unequivocally that he doesn't believe he should have to report income from earnings outside the United States, and that having to declare ownership of foreign bank accounts to U.S. taxing authorities is "complete [was that Dutch?]." After a careful analysis of all the foreign account statements, the unreported interest income from such accounts, and with Client A's personal view of the United States' worldwide tax system in mind, it is clear that the OVDP (because of its non-discriminating nature toward taxpayers that would otherwise likely be deemed to have been "willful" in their non-reporting and non-disclosure) is Client A's best option. It's April 10th, 2018, and the 2017 tax return for Client A is due in a week. In 2017, Client A sold a family vacation home he inherited 15 years ago for the equivalent of $4 million USD, the proceeds from which he deposited directly into one of those foreign accounts, raising the total balance to the aforementioned $6 million USD from a previous high of approximately $2 million. This home was never rented out for any purpose by Client A, and thus there was no income derived from it.[10] Based on FAQ 9's language stating that the voluntary disclosure period constitutes the most recent 8 tax years (including proper extensions) for which the due date has passed, Client A has an important choice to make. If Client A submits the voluntary disclosure before the April 17th due date, the disclosure period will include the years

[10] *See id*., FAQ 35. Had there been rental income earned from the home and not declared by Client A on his U.S. tax return(s), the home's fair market value would be included as part of the penalty base to which the Offshore Penalty applies.

2009-2016. That's great news, considering the Offshore Penalty of 27.5% under that scenario will be applied to a high aggregate balance of $2 million rather $6 million (a difference of $1.1 million in that penalty alone ($550,000 vs. $1,650,000)). However, due to the amount of additional work that still has to be done in order to properly submit the disclosure, doing so one week from now might be impossible. By filing the extension, Client A has bought more time in order to obtain and produce all the necessary information and documentation required, and still take advantage of a much more favorable penalty structure based a disclosure period that won't include the additional $4 million USD deposited into his foreign account from the vacation home sale in 2017.

But wait a minute. What if, in the course of assembling the rest of the information in early May, it comes to light that in 2009 Client A actually had another unreported foreign account that he'd forgotten about? Upon closer inspection, this account was jointly held by Client A and his father, who still lives in Amsterdam and has never set foot in the United States. The statements reflect that in October of 2009, the account had a high balance the equivalent of $8 million USD. In December of that year, Client A and his father had a falling out and since the money was all really Dad's anyway, Client A consented to his name being taken off the account and his interest and authority over the funds within being terminated for all legal purposes. During 2009, the high balance in all of Client A's other foreign accounts was $1 million USD. If the voluntary disclosure period remains 2009-2016 as planned when filing the extension, all the sudden the Offshore Penalty calculation results in a bill of $2.475 million – an increase of $1.925 million! Is Client A stuck? Not necessarily. Remember, the disclosure period is based upon tax years for which the tax return due date, including extensions, has passed.[11] Client A can choose to wait until the extended due date passes in mid-October (and after filing his 2017 tax return) before submitting

[11] *See* Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers, FAQ 9.

the voluntary disclosure. If he does, the disclosure period now includes tax years 2010-2017, and an Offshore Penalty of $1.65 million that now looks pretty good relatively speaking.

It is important to note however, that this latter path is wrought with great risk and uncertainty. That's because with the implementation of the Foreign Account Tax Compliance Act ("FATCA") in July of 2014 and the ongoing disclosure by foreign financial institutions of their U.S. account holders' information to the IRS pursuant thereto, the risk of U.S. taxpayers' noncompliance being detected before they come forward – and thus eliminating them from the voluntary disclosure process altogether – grows greater by the day.[12] While recent attempts to repeal FATCA have not proven successful, the results of the November election coupled with promised tax reform may change that. Most recently, Senator Rand Paul (R-Kentucky) and Representative Mark Meadows (R-NC) have introduced legislation in their respective chambers to repeal the law.[13] But until and unless that comes to pass, taxpayers with unreported foreign accounts and assets that don't make the decision to come forward will be forced to keep looking over their shoulders.

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[12] *See id.*, FAQ 14 (explaining that taxpayers already under civil or criminal examination by the IRS or CID are ineligible to participate in the OVDP); *see also id.*, FAQ 21 (listing other ways in which taxpayers may become ineligible due to information being shared about them by foreign financial institutions or governments).
[13] S. 869, 115th Cong. (introduced April 6, 2017); H.R. 2054, 115th Cong. (introduced April 6, 2017).

A BRIEF INTRODUCTION TO PRE-IMMIGRATION TAX PLANNING

John R. Strohmeyer & Ryan C. Furtick

The digital economy makes it easy for people and money to move across international borders. If the United States is not involved, then generally a nonresident of the United States will have few, if any, interactions with the IRS. But as more foreign citizens look to the U.S. as a place to invest, advisers need to be aware of the tax laws that apply to nonresidents.[1] Why? When a nonresident becomes a "resident" of the U.S. for tax purposes, the tax rules change dramatically, and if not anticipated, the consequences can be severe.

Any person who is considering spending more time in the United States should be aware of the two tax systems that affect individuals: the federal income tax and the federal "wealth transfer" taxes—the estate tax, the gift tax, and the generation-skipping transfer tax. Addressing either of these tax systems could fill volumes, so this article will only briefly address both. Part I will address the income tax aspects of the immigration process, and Part II will address the wealth transfer tax aspects of the immigration process.

Because of the complexity involved in planning for any one of these taxes, this article will only provide a cursory introduction to the concepts involved in immigration tax planning. And beyond the rules outlined in this article, the United States is a party to over 50 bilateral income tax treaties and several bilateral estate and gift tax treaties, each of which creates a unique taxing regime between the two countries. For these reasons, many concepts have been abbreviated or left out entirely to provide a brief overview. And while we've divided these topics for this article, the planning involved in the immigration process involves planning for both systems.

Part I: Income Tax

Decades ago, Congress implemented a worldwide taxation system, meaning that U.S. citizens and residents are subject to U.S. income tax on their worldwide income. This is dramatically different than most countries, which use a territorial system to impose income tax only on the income generated within that country's own borders. To offset potential double taxation, the U.S. allows taxpayers to use worldwide expenses to reduce worldwide income, and grants a foreign tax credit for foreign income taxes paid on income generated outside of the United States.

[1] *See* Jesse Drucker, *The World's Favorite New Tax Haven Is the United States* (available at http://www.bloomberg.com/news/articles/2016-01-27/the-world-s-favorite-new-tax-haven-is-the-united-states).

Because of the differences between the U.S.'s worldwide taxation system and the territorial taxation system, nonresidents must know how and when they will be treated as residents for U.S. tax purposes. For income tax purposes, non-citizens are divided into two groups: residents and nonresidents. An income tax resident is a person who satisfies one of two tests: the legal permanent resident test and the substantial presence test.

- The legal permanent resident test (also known as the "green card test") is satisfied if a person is a lawful permanent resident of the United States (because they have been granted a "green card," and with it, the right to legally reside in the United States) at any point during the tax year.[2]
- The substantial presence test, although more complicated, is satisfied if a person is present in the United States for at least 31 days during the calendar year, and for 183 or more total days during the current year and the previous two years (with only a fraction of each day from the prior two tax years being counted). A person who can demonstrate a closer connection to another country may qualify for an exemption to the substantial presence test.[3]

Both tests produce a clear result based on bright-line rules. Once determined to be a resident under either test, residents must file income tax returns to report and pay tax on their worldwide income.

But if not determined to be a resident, then nonresidents are only subject to income tax on income derived from sources within the U.S. And instead of a single set of tax rules applicable to all income, the income derived by a nonresident breaks down into four broad categories of taxation.

Effectively Connected Income ("ECI")—Nonresidents are generally taxed in the same manner on effectively connected income as citizens and residents: only the net income (i.e., applicable deductions are allowed) is taxed at graduated rates. The determination of whether income is effectively connected with a U.S. trade or business is a two-prong test. Under the first prong, the taxpayer must be engaged in a U.S. trade or business. Under the second prong, any income must be effectively connected with a U.S. trade or business.

It is possible for a nonresident alien to have both effectively connected income and non-effectively connected income in the same year. If the nonresident alien has both, the filing of a return will almost always be required. If the nonresident alien only had non-effectively connected income and income tax is withheld at the source, no return would likely need to be filed.

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[2] Code § 7701(b)(1)(A)(i)

[3] Code § 7701(b)(1)(A)(ii), (b)(3). An individual may also elect under Code § 7701(b)(4) to be treated as a resident alien in the year before satisfying the substantial presence test.

A nonresident alien individual's income from the conduct of a U.S. trade or business includes income from the performance of personal services within the U.S. at any time during the tax year. However, if the services are performed for a foreign employer, the aggregate compensation does not exceed $3,000, and the nonresident alien employee is present in the U.S. for 90 days or less during the tax year, then the nonresident alien individual will not be treated as being engaged in a U.S. trade or business.[4]

A foreign person who trades in stocks, securities, or commodities in the U.S. is not treated as conducting a U.S. trade or business (and is not subject to U.S. income tax on his or her "effectively connected income" from the securities or commodities trading) if the foreign person does not have an office in the U.S. through which, or under the direction of which, the securities transactions are affected.[5] If a foreign individual engages in transactions for the taxpayer's own account, safe harbor rules enable that foreign individual to avoid being treated as conducting a U.S. trade or business even if he or she has an office in the U.S. that otherwise would cause that income to be effectively connected income.[6]

Fixed, Determinable, Annual, or Periodical Income ("FDAP" Income)—FDAP Income is generally passive income realized by nonresidents earned from U.S. sources that is not "effectively connected" with a U.S. trade or business (e.g., dividends, interest, rent, and royalties). FDAP Income taxed at a flat 30% rate. A significant drawback to being taxed at a flat rate is that a taxpayer is taxed on the gross amount received, and is not allowed deductions for the expenses of producing such income. The flat 30% tax is also imposed on original issue discount on certain debt obligations,[7] net gains from the sale of capital assets of taxpayers who have been present in the United States for 183 days or more during the taxable year,[8] and 85% of any social security benefits.[9]

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[4] Code § 861(a)(3).

[5] Code § 864(b)(2).

[6] Code §§ 864(b)(2)(A)(ii), (B)(ii).

[7] Code § 871(a)(1)(C). Original issue discount accrues over the life of the debt instrument under rules in Code § 1273. Nonresidents are taxed on accrued OID when payments are made on the instrument, or when an OID obligation is sold or exchanged.

[8] Code § 871(a)(2). Note that in most cases, a person who is present in the United States for more than 183 days during a taxable year is treated as a resident for U.S. federal income tax purposes, and would thus be subject to tax at graduated rates on his worldwide income. Thus, the scope of the rule under Code § 871(a)(2) is narrow. However, certain persons, including students and foreign government officials, may avoid U.S. resident status even if present in the United States for more than 183 days in a year. Such persons would thus be subject to the Code § 871(a)(2) regime.

[9] Code § 871(a)(3).

Sales of U.S. Real Property and the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA" Income)—Nonresidents may elect to treat their real property gains as effectively connected income. Before the enactment of the Foreign Investment in Real Property Tax Act ("FIRPTA") in 1980, a foreign person could invest in US real property without being subject to U.S. income tax on the later sale or disposition of that U.S. real property, providing a great advantage to foreign investors. FIRPTA treats a foreign individual's gain and loss from the disposition of a U.S. real property interest as income or loss effectively connected with a U.S. trade or business. Additionally, while income from real property (e.g., rent and royalties) would be treated as FDAP income (and subject to 30% tax), nonresidents may elect to treat that income as effectively connected income so that is taxed on a net basis at graduated rates.

Generally, the purchaser of a foreign person's real property must withhold 15% of the purchase price (not the gain on the sale), and remit that amount to the IRS.[10] The withholding rate is 10% if the purchase price is less than $1,000,000 and the property is acquired for use as a residence.[11] This withholding may not be the actual amount of tax due on the disposition, and is only an advance payment toward the final income tax due. So, the foreign investor will need to file the appropriate income tax return (e.g., Form 1040NR or Form 1120F) to report the sale. Any tax withheld on the sale will be credited against the amount of tax due on the return.[12]

There are several exemptions to this withholding. For example, if the purchaser acquires the property to use as a residence and the amount realized does not exceed $300,000, then no withholding is required.[13] Additionally, no withholding is required if the seller provides the purchaser with an affidavit stating, under penalty of perjury, the seller's United States taxpayer identification number and that the seller is not a foreign person.[14]

Income Not Subject to Income Tax—A few types of income, such as interest generated by assets held in a bank account, escape income tax entirely. For example, a foreign taxpayer is not subject to income tax on U.S.-source capital gains not effectively connected with a U.S. trade or business. Interest on bank deposits with U.S. banks paid to nonresident aliens or foreign corporations is not taxed if the interest is not effectively connected with the foreign person's U.S. trade or business.[15]

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[10] Code § 1445(a); Treas. Reg. § 1.1445-1(c)(1).

[11] Code § 1445(c)(4), Treas. Reg. § 1.1445-1(b).

[12] Treas. Reg. § 1.1445-1(f)(1).

[13] Code § 1445(b)(5).

[14] Code § 1445(b)(2).

[15] Code §§ 871(i)(2)(A), 881(d).

Part II: Wealth Transfer Tax Planning

As with the income tax, U.S. citizens and residents are subject to worldwide taxation by the three wealth transfer taxes: the estate tax, the gift tax, and the generation-skipping transfer tax. Nonresidents are only subject to wealth transfer taxation on their U.S.-situs assets. So, while these taxes are different from the income tax, the principle that nonresidents are taxed only on assets that are located in the U.S. is similar to the principal in income taxation that the U.S. only taxes income that is connected with the U.S.

Residence

Although the income tax uses an objective test to determine residence, the residence test for the wealth transfer taxes is subjective. The test is satisfied if a person is domiciled in the U.S. at the time of either his or her death or transfer by gift. A person acquires U.S. domicile by residing in the U.S. for any period of time, no matter how brief, with no definite present intention of leaving.[16] Absent that intention, a person will not acquire domicile for the purposes of wealth transfer taxation. As a result, the determination of residence for wealth transfer tax purposes requires a determination of an individual's state of mind at the requisite moment. Once determined to be a resident under this subjective test, a resident is required to file Forms 709 to report lifetime gifts, or the resident's estate must file a Form 706 if required to do so.

A person who is not a U.S. citizen and who does not have a U.S. domicile is a "nonresident not a citizen of the United States" for wealth transfer tax purposes.[17] For simplicity in this article, a "nonresident not a citizen of the United States" will be referred to as a "nonresident." Because this test is different than the residence test for income tax, it is possible for an individual to be a resident for income tax purposes without being a resident for wealth transfer tax purposes, and vice versa.

Generally, a person's domicile continues to be his or her place of birth until it is affirmatively shown that the person acquired a different domicile. A person who resides in the U.S. without knowing when he or she will return home should not acquire a U.S. domicile. For example, a person who moved to the U.S. in 1940 from The Netherlands to escape the Nazis and intended to return home when it was safe did not

[16] Code § 2001(a); Treas. Reg. §§ 20.01-1(b); 25.2501-1(b).

[17] Code §§ 2101(a), 2511(a).

acquire a U.S. domicile.[18] If doubt exists as to whether a new domicile has been acquired, then it is likely that the person's domicile has not changed.[19]

Estate Tax

The U.S. only imposes the estate tax on U.S.-situs assets of nonresidents, though the estate tax is computed in the same manner as U.S. citizens and residents. As a result, the nonresident's estate tax will be equal to the excess of the taxable estate plus any adjusted taxable gifts over the tentative tax on the amount of the adjusted taxable gifts.[20] Two important differences in this calculation (but not the only differences) for the nonresident are the assets included in the estate and the availability of deductions.

A nonresident's estate will only be subject to the estate tax only on U.S.-situs assets. For example, real property and tangible personal property located in the United States are included in the nonresident's estate.[21] But leases are generally not included in the gross estate.[22] Stock in corporations organized under U.S. law, but not the underlying assets, are included in the nonresident's estate.[23]

Although U.S.-situs property is included in a nonresident's gross estate, several classes of assets are excluded from the gross estate. For example, real property and tangible personal property located outside the United States are excluded from the gross estate.[24] To encourage nonresidents to loans works of art to U.S. museums, works of art owned by a nonresident that are at the time of death on loan or exhibition in the United States are excluded, even though they are located in the United States.[25] Shares of stock in a corporation organized and incorporated under the laws of a foreign country are excluded.[26] The proceeds of a life insurance policy on the life of a nonresident are also excluded from the gross estate, regardless of the situs of the company that issues the policy.[27] Additionally, nonresidents may exclude debt obligations issued by a U.S.

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[18] *Estate of Nienhuys v. Comm'r*, 17 T.C. 1149, 1159 (1952).

[19] *Estate of Khan v. Comm'r*, T.C. Memo 1998-22 (citing *Weis v. Comm'r*, 30 B.T.A. 478, 487 (1934)).

[20] Code § 2101(b)(1)-(2).

[21] Treas. Reg. § 20.2104-1(a)(1)-(2).

[22] *Estate of de Perigny v. Comm'r*, 9 T.C. 782 (1947).

[23] Code § 2104(a).

[24] Treas. Reg. §§ 20.2105-1(a)(1), (2).

[25] Code § 2105(c).

[26] Treas. Reg. § 20.2105-1(f).

[27] Code § 2105(a)

corporation, as well as deposits with a U.S. bank if the interest would be treated as foreign source income, or would be exempt from tax as portfolio interest or the rules applicable to interest paid on deposits with U.S. banks.[28] Deposits with a foreign branch of a U.S. commercial bank will be excluded from the gross estate.[29]

Because fewer assets are included in a nonresident's gross estate for estate tax purposes, a nonresident decedent only receives a $13,000 estate tax credit (effectively a $60,000 exemption amount),[30] as opposed to the $5,490,000 estate tax exclusion amount available for U.S. citizens and residents in 2017.[31] The nonresident decedent estate tax credit is not adjusted for inflation.

Beyond a limited estate tax credit, nonresidents may only claim limited deductions for estate tax purposes. For example, a nonresident may deduct general expenses of administration, debts, taxes, funeral expenses, and losses of the worldwide estate as a U.S. citizen or resident would.[32] But the amount of the deduction is limited to the ratio of the nonresident's U.S. gross estate to the worldwide estate. Additionally, it does not matter if the amounts to be deducted were incurred or expended within or without the United States.[33] To obtain these deductions, the nonresident's estate must disclose the decedent's worldwide estate on the estate tax return. No deduction will be allowed unless the value of the decedent's entire gross estate is disclosed in the estate tax return.[34] Thus, an estate must balance the ability to claim these deductions against the need to disclose.

So, if a nonresident decedent had a worldwide gross estate valued at $10,000,000, of which the U.S. gross estate is valued at $1,000,000, only 10% of the debts, taxes, and funeral and administration expenses would be deductible, regardless of whether they are directly attributable to the administration of the U.S. estate. But before claiming any deductions, the estate would need to report the entire $10,000,000 estate, even though only $1,000,000 would be subject to the estate tax.

Regardless of a decedent's residence, the unlimited marital deduction is not available for assets that pass to a surviving spouse who is not a U.S. citizen.[35] But the marital

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[28] Code §§ 2104(c); 2105(b)(1) and (3)

[29] Code § 2105(b)(2).

[30] Code § 2102(b)(1).

[31] Code § 2010(c); Rev. Proc. 2016-55, Sec. 3.35, 2016-55 IRB 707.

[32] Code § 2106(a)(1).

[33] Treas. Reg. § 20.2106-2(a)(2).

[34] Treas. Reg. § 20.2106-2(b) .

[35] Code § 2056(d)(1).

deduction can be obtained by using a qualified domestic trust (QDOT). An additional estate tax is imposed on distributions of corpus from the QDOT during the surviving spouse's lifetime and on the value of the QDOT corpus on the date of death of the surviving spouse.[36] The additional estate tax is generally equal to the tax that would have been due if the property had been included in the decedent's estate. The trustees are personally liable for this tax.[37]

A charitable deduction is allowed for the full amount of all bequests, legacies, devises, or transfers to certain domestic recipients.[38] Generally, the recipient must be the United States; any U.S. state or any political subdivision or a U.S. state; the District of Columbia; any domestic corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes; or a trustee or trustees, or a fraternal society, order, or association operating under the lodge system.[39] Unlike administrative expense and loss deductions under Code § 2106(a)(1), the charitable deduction is not proportionate to the ratio of U.S. and worldwide property. But like deductions under Code § 2106(a)(1), the charitable deduction is only allowed if the executor discloses worldwide gross estate.[40] Again, the nonresident's executor must choose between disclosing worldwide assets and foregoing the charitable deduction.

Gift Tax

Nonresidents are subject to the gift tax on all transfers.[41] Like the estate tax, the gift tax only applies to a nonresident's gifts of U.S.-situs property, and not worldwide transfers.[42] Because fewer assets have a U.S. situs for the gift tax than the estate tax, the gift tax presents less of an issue for nonresidents than the estate tax. Generally, real property and personal property physically located in the United States are subject to the gift tax.[43] So if a nonresident were to gift $50,000 in jewelry while standing on Miami Beach, the gift would be subject to gift tax. But if that same nonresident and the donee boarded a boat and headed into international waters, the same transfer would not be subject to gift tax.

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[36] Code § 2056A(b).

[37] Code § 2056A(b)(6).

[38] Code § 2106(a)(2).

[39] Code § 2106(a)(2)(A)(i)-(iii).

[40] Treas. Reg. § 20.2106-1(b).

[41] Code § 2501(a)(1).

[42] Code § 2511(a).

[43] Treas. Reg. § 25.2511-3(b)(1)

A nonresident is not subject to U.S. gift tax on a transfer of property not located in the United States. Transfers of intangible property by a nonresident are not subject to the gift tax.[44] Bank deposits or treasury bills are generally considered intangible property for gift tax purposes.[45]

Although a nonresident is not granted any lifetime exemption from gift tax, a nonresident gets many of the same deductions and exemptions as a U.S. citizen or resident. A nonresident receives the same per donee annual exclusion ($14,000 per donee in 2017) that is granted to U.S. citizens and residents on transfers of U.S.-situs assets.[46] As with U.S. citizens and residents, the payment of qualified educational and medical expenses by a nonresident is excluded from the gift tax.[47]

Generation-Skipping Transfer Tax

In addition to the estate tax and the gift tax, nonresidents are generally subject to the generation-skipping transfer tax ("GST tax") if the transfer is otherwise subject to the estate tax or gift tax.[48] The GST tax serves as a backstop to the estate tax and the gift tax by taxing transfers that "skip" a generation (e.g., a gift from a grandparent to a grandchild). Although nonresidents receive a GST exemption, it is not clear if that amount is $1,000,000[49] or $5,490,000 (the amount granted to U.S. citizens and residents in 2017).

Conclusion

Even this brief introduction to the U.S. income tax and wealth transfer taxes shows the varied rules, exceptions, requirements, and exemptions that apply to both U.S. residents and nonresidents. Taken together, a complex web of rules presents many traps for the unwary. But the increased amount of investment in the U.S. by foreign citizens looking for a safe haven for their investments presents opportunities for these tax traps to be sprung. The tax planning needed to avoid these tax traps will take on a greater importance in the coming years as it becomes easier to transfer money and property into the United States.

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[44] Code § 2501(a)(2).

[45] Treas. Reg. § 25.2511-3(b)(4).

[46] Code § 2503(b)(1); Rev. Proc. 2016-56, Sec. 3.37(1), 2016-56 IRB 707.

[47] Code § 2503(e).

[48] Treas. Reg. § 26.2663-2(b)(1).

[49] Treas. Reg. § 26.2663-2(a).

Guide to bond premium and market discount

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Market purchases of bonds, adjustments to taxable Income and Forms 1099

For taxpayers who purchase bonds or other debt instruments (Bonds), the Tax Code[1] may require adjustments to ordinary interest income. This guide addresses two types of adjustments – bond premium and market discount.

Where they apply, the bond premium and market discount rules affect the characterization of Bond holders' income as capital or ordinary, as well as the timing of certain ordinary interest income. Both the bond premium and market discount rules generally affect the amount of gain or loss and ordinary income recognized upon sale or disposition of a Bond. Bond premium adjustments to interest income may also apply while the taxpayer holds a Bond.

1 All references herein to "section" or "Tax Code" refer to the Internal Revenue Code of 1986, as amended, and all references to "Reg. section" are to the regulations issued thereunder.

The bond premium and market discount rules both address situations where a Bond holder has purchased a debt instrument at a price that differs from a baseline amount. The applicable baseline amount is often, but not always, equal to the Bond's stated principal amount (often known as its 'face amount' or 'par value'). For bond premium, the baseline amount is the amount of all remaining payments other than qualified stated interest. For market discount, the baseline amount is the Bond's adjusted issue price.

Bond premium and market discount arise because of market price changes. For example, a Bond's value may decrease due to an increase in market interest rates or deterioration of the issuer's credit quality. Conversely, a Bond value may increase due to a decrease in market interest rates or improvement of the issuer's credit quality.

Bond holders generally receive Forms 1099 annually unless they are 'exempt recipients.' Exempt recipients generally include corporations, governments, tax-exempt entities and certain other taxpayers (S corporations, however, are not exempt recipients with respect to Forms 1099-B). Bond holders' Forms 1099-B (regarding sales proceeds and tax basis) and 1099-INT/OID (regarding interest income) often reflect bond premium and market discount-related information.

The level of completeness and accuracy of the Form 1099 information, however, may vary. For example, variations in Form 1099 accuracy may arise because the Form 1099 rules authorize brokers to make certain assumptions about tax elections made by their customers. Where these assumptions are not consistent with the actual tax elections made by the customer, amounts shown on the Form 1099 may vary from those the customer is required to report on his or her tax return. This guide includes recommendations for dealing with some of these variations.

Certain taxpayers, such as banks and securities dealers, are subject to special rules that generally lessen the impact of the bond premium and market discount rules. This guide focuses on debt investors—taxpayers who hold Bonds as capital assets.

Bond premium amortization

The bond premium rules address situations in which a Bond holder has purchased a debt instrument at a price that exceeds a baseline amount. The baseline amount is the amount of all remaining payments other than qualified stated interest (QSI). At purchase of the Bond, the amount of the bond premium is the excess of the purchase price over this baseline amount.[2] This baseline amount often, but not always, is equal to the Bond's stated principal amount (which is often known as its face amount or par value). QSI is interest that is unconditionally payable (in cash or other property other than debt of the issuer) annually or more frequently over the term of the Bond at a fixed or qualified variable rate.[3]

For taxable Bonds, applying the bond premium rules is elective. For tax-exempt Bonds, however, applying the bond premium rules is mandatory.[4]

A Bond holder who acquired a taxable Bond with bond premium and has not previously elected to amortize bond premium may either (1) elect to amortize the premium over the term of the Bond and, correspondingly, reduce the basis in the Bond by such amortization, or (2) make no election and include the full amount of the premium in the tax basis of the Bond. Where amortization applies, bond premium is amortized using the constant yield method (also known as the constant interest rate method).[5]

To make the bond premium amortization election for taxable Bonds, the taxpayer must offset the annual bond premium amortization amount against the QSI from each Bond acquired with bond premium.[6] A statement drawing attention to the election should be attached to the return; a sample statement is provided below. The statement, however, neither effects nor affects the election.[7]

2 Section 171(b)(1), Reg. section 1.171-1(d)(1).
3 Section 171(b)(1), Reg. section 1.171-1(d)(1).
4 Section 171(a), 171(c)(1), Reg. section 1.171-1(c).
5 Section 171(b)(3), Reg. section 1.171-2.
6 Reg. section 1.171-4(a)(1).
7 See id.

The election to amortize bond premium applies to all taxable Bonds with bond premium held at the beginning of the taxable year to which the election applies, and all Bonds acquired thereafter[8]. The election is revocable with the consent of the IRS,[9] and the IRS has provided an automatic consent procedure for revoking this election.[10]

Because bond premium amortization is mandatory for tax-exempt Bonds, a Bond holder who has acquired a tax-exempt Bond with bond premium must amortize the premium over the term of the Bond, reducing the basis in the Bond by such amortization.[11] If tax-exempt Bonds are held to maturity and their principal repaid in full, the Bond holder generally recognizes no gain or loss, as any premium has been fully amortized. If the Bond holder sells or disposes of tax-exempt Bonds before maturity, gain or loss may be recognized with reference to the difference between (a) the proceeds received and (b) the sum of the Bond holder's original purchase price plus all amortized premium to date. Failing to amortize the bond premium and retaining it in tax basis to reduce gain or increase loss on sale or disposition of a tax-exempt Bond is not permitted.

Questions regarding a taxpayer's amortization of bond premium

The following questions are intended to help assist a taxpayer in determining whether to elect to amortize bond premium, making the election, and addressing certain issues to be aware of with regard to bond premium amortization reporting by brokers.

Typically, it is in a Bond holder's interest to elect to amortize bond premium on taxable Bonds, because making the election may result in the Bond holder reporting less ordinary income while holding the Bonds, and less capital loss (or more capital gain) upon sale, disposition or redemption of the Bond if the taxpayer holds the Bond as a capital asset.

1. **Does the taxpayer's investment portfolio include Bonds?**
    a. If no, you need not answer the remaining questions. However, the taxpayer's investment portfolio may need to be reviewed each year to answer this question.
    b. If yes, see question 2.

2. **Were the Bonds in the taxpayer's portfolio acquired with bond premium? As noted above, bond premium is equal to the excess of the Bond purchase price over a baseline amount—the amount of all remaining payments, other than QSI. This baseline amount often, but not always, equals the Bond's stated principal amount (which is often known as its face amount or par value).**
    a. If no, see the questions below relating to Bonds purchased at a discount.
    b. If yes, see question 3.

3. **Were some tax exempt Bonds acquired with bond premium (i.e., is interest on some of the Bonds excluded from income under section 103)?**
    a. If no, see question 4.
    b. If yes, amortizing bond premium on the tax-exempt bonds is mandatory, not elective. The bond premium amortization must be applied as an offset to tax-exempt interest income, and the tax basis of the Bond reduced by the annual amortization amounts. Brokers generally are required to report the annual amount of premium amortization as a reduction to tax-exempt interest income and adjust the basis for such amortization annually if the Bond was acquired after Dec. 31, 2013 (or in some cases, a later date).[12] Bond premium amortization is computed using the constant yield method (also known as the constant interest rate method).
    Be aware: You should consider state taxation of tax-exempt bond interest and bond premium. The interest from those Bonds may be subject to state income tax. In addition, certain states may not require (or permit) amortization of bond premium on tax-exempt bonds.
    Next, see question 4.

8 Reg. section 1.171-4(b).

9 Section 171(c)(2), Reg. section 1.171-4(d).

10 Rev. Proc. 2016-29 section 5.01.

11 Section 1016(a)(5), Reg. section 1.1016-5(b)(3).

12 Reg. section 1.6045-1(n)(7)(ii)(B) (for effective date, see Reg. sections 1.6045-1(a)(15)(i)(C) and 1.6045-1(n)(2)).

4. **Were some taxable Bonds acquired with bond premium (i.e., is interest on some of the Bonds not excluded from income under section 103)?**
   a. If no, there is no need to consider the election to amortize bond premium.
   b. If yes, see question 5.

5. **Has the taxpayer previously elected to amortize bond premium?**
   a. If no, see question 6.
   b. If yes, the taxpayer must continue to amortize bond premium for all Bonds (unless the taxpayer revokes the election, as noted above). Bond premium amortization is computed using the constant yield method (also known as the constant interest rate method). The bond premium amortization is applied as an offset to interest income and the tax basis of the Bond is reduced by the annual amortization amounts.[13] Brokers generally are required to report the annual amount of premium amortization as a reduction to interest income and adjust the basis for such amortization annually if the Bond was acquired after Dec. 31, 2013 (or in some cases, a later date).[14]
   c. Next, see question 9.

6. **What is the effect of making the election to amortize bond premium on taxable bonds?**
   a. Amortizing premium on taxable bonds offsets a ratable portion of the taxable QSI from such bonds each year, thereby reducing taxable income.
   b. The basis of the taxable bond must be reduced to account for the amount amortized each year.
   c. The adjustment to cost basis for the amortization of premium impacts potential gain or loss upon disposition of the Bond (generally capital gain or loss if the taxpayer holds the Bond as a capital asset).
   d. The overall effect typically is to decrease interest income while holding the Bond and later recognize a reduced capital loss (or increased capital gain).
   e. If taxable Bonds are held to maturity and their principal paid in full, the Bond holder generally would recognize no gain or loss, as any premium would be fully amortized. If the Bond holder instead disposes of the Bonds before maturity, gain or loss may be recognized with reference to the difference between (a) the proceeds received and (b) the sum of the Bond holder's original purchase price plus all amortized premium to date.
   f. The election is irrevocable without IRS consent (the IRS has provided an automatic consent procedure, as noted above), and applies to all taxable Bonds held at the beginning of the taxable year to which the election applies and all Bonds acquired thereafter.
   g. Next, see question 7.

7. **Does the taxpayer wish to make an election to amortize taxable bond premium?**
   a. If no, the taxpayer cannot offset annual taxable bond premium amortization against QSI from those Bonds.
      Be aware: For taxable bonds purchased at a premium after Dec. 31, 2013 (or, for certain types of Bonds, after a later date), brokers generally are required to report income on those Bonds as though the taxpayer has elected to amortize the premium and adjust the basis of those Bonds for the amount of premium amortization. This is true regardless of whether the taxpayer made the election. However, the taxpayer can notify the broker before the end of the taxable year that they are not making the election and request that the amortization not be calculated.[15]
      Be further aware: The taxpayer cannot treat the amortization as an offset to QSI unless you have made the election to do so. Regulations require brokers to report as though their customer has made the election to amortize bond premium for taxable Bonds acquired after Dec. 31, 2013 (or, in some cases, a later date), absent communication by the customer to the broker to the contrary.
   b. If yes, see question 8.

13 Section 171(e), Reg. section 1.171-2(a)(1); section 1016(a)(5), Reg. section 1.1016-5(b)(1).

14 Reg. sections 1.6049-9(b), 1.6045-1(n)(7)(ii)(A).

15 Reg. section 1.6045-1(n)(5)(ii)(A).

8. **The taxpayer has decided to elect to amortize taxable bond premium. How is the election made?**

   a. The election is made by offsetting annual amortization of bond premium against the QSI from each such Bond.
   Be aware: There are exceptions to this treatment listed below in *Exceptions to the General Rule on Amortization of Bond Premium*. Be further aware: Once made, the election applies to all taxable Bonds held by the taxpayer on the first day of the tax year for which it is made and all taxable Bonds acquired thereafter. Revoking the election requires consent of the IRS and the IRS has provided an automatic consent procedure.

   b. **Be aware:** A Bond holder should also attach a statement to the federal income tax return for the tax year in which the election is made. A sample statement is shown below. The statement neither effects nor affects the election. It does, however, generally make clear to anyone reading the return that the taxpayer elected on the return to amortize taxable bond premium. As noted above, the election is actually made by offsetting the bond premium amortization against the QSI from the Bonds on the return.

9. **What are some issues you may encounter related to taxable bond premium amortization?**

   a. **Issue: Reporting interest income net of taxable bond premium amortization.** For covered Bonds[16] (generally, Bonds acquired after Dec. 31, 2013), brokers report premium amortization regardless of whether the taxpayer has elected to do so (subject to the exception above where the taxpayer has otherwise notified the broker otherwise). Some brokers have been known to net interest income from such Bonds against that taxable period's amortization rather than report them separately. If the taxpayer has not made the election, be sure the taxpayer does not underreport interest income by using the netted figure from the Form 1099. **Recommendation:** Check the detail on the Form 1099 to determine the total reportable interest income.

   b. **Issue:** Underreporting of basis due to reported amortization without election. Related to the issue described in 7a, above, some brokers will adjust basis on covered and non-covered Bonds[17] as though the premium was amortized and offset against interest income. This results in an underreporting of basis on the Bonds that could lead to reporting phantom capital gain or a smaller capital loss on the tax return and a potential overpayment of tax.
   Recommendation: Compare the original tax basis on taxable covered and non-covered Bonds to the basis reported upon disposition on the Form 1099 and realized gain/loss statement. If the election has not been made, any adjustment made to the Bond's tax basis for amortization of taxable Bond premium may need to be reversed on Form 8949.

   c. **Issue:** Underreporting of cost basis on taxable Bonds subject to the election. When the taxpayer has a portfolio comprised of both taxable covered Bonds and non-covered Bonds and makes the election to amortize bond premium, there have been a number of instances in which the broker adjusts cost basis as though the election was made at the time the Bonds were acquired rather than as of the beginning of the tax year in which the election was made. The underreported basis results in a loss of tax benefit to the taxpayer and possible over-reporting of income and payment of tax. **Recommendation:** Carefully track the basis on taxable Bonds to ensure the correct adjusted basis is reported when taxable Bonds subject to the election are sold or redeemed.
   Be aware: This can be costly to the taxpayer in terms of tax return preparation fees and time-consuming for the tax return preparer. It is a good practice to discuss this with the taxpayer set expectations regarding who will track the basis of taxable Bonds subject to the election.

   d. **Issue:** Commingling premium amortization on taxable and tax-exempt Bonds. For portfolios that contain both taxable and tax-exempt Bonds, some brokers report the premium amortization for both on the bond premium line of the 1099-INT. **Recommendation:** Carefully examine the supporting statements to the 1099-INT to ensure amortization from tax-exempt Bonds is not used to offset taxable interest income.

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16 Covered Bonds generally are Bonds acquired after Dec. 31, 2013, except that for certain more complex debt instruments are covered Bonds only if acquired after Dec. 31, 2015. Reg. sections 1.6045-1(a)(14)(ii), -1(a)(14)(ii), -1(a)(15)(i)(E), -1(a)(15)(i)(D), -1(n)(2)(i), -1(n)(3).

17 Non-covered Bonds are Bonds that are not covered bonds. For an explanation of the term 'covered bonds,' see Note 15 above.

e. **Issue:** Non-reporting of bond premium amortization on non-covered Bonds on the face of Form 1099. Form 1099 reporting of amortization of taxable covered Bonds and taxable non-covered Bonds. Some brokers are only reporting amortization of taxable covered Bonds on the face of the Form 1099 INT and are showing the amortization of taxable non-covered Bonds as supplemental information. **Recommendation:** Be sure to carefully review the supplemental information contained in the Forms 1099.

Exceptions to the general rule of amortization of bond premium

There are exceptions and limitations on the offset to interest income by bond premium amortization. You should be aware of the following:

To the extent the amount of bond premium amortization for any accrual period exceeds the QSI for the period, the difference may be deducted by individual Bond holders as a miscellaneous itemized deduction.[18] This miscellaneous itemized deduction is limited to the amount by which the total interest inclusions on the Bond in prior accrual periods exceeds the total bond premium offset against such interest in prior periods.[19] Any bond premium in excess of this limit is not deductible in the current year, but can be carried forward to the next period.[20]

- Any amount of bond premium attributable to the conversion feature of a convertible Bond is not deductible; bond premium amortization is not available for this amount.[21]
- There are additional rules that apply to the amortization of premium on variable-rate debt instruments, inflation-indexed instruments, and Bonds subject to contingencies (including contingent payment debt instruments).[22]

Bond discount: Original discount and market discount

The term 'discount Bond' generally describes a fixed-income instrument issued or sold at a price lower than its stated maturity value. The attractiveness of a discount Bond to investors is enhanced by the expectation of receiving more at maturity than the investment made upon purchase. Discount Bonds exist in two general forms: market discount Bonds and original issue discount (OID) Bonds.

OID bonds and OID accrual

OID Bonds generally are issued at a discount to their maturity value. These include, but are not limited to zero-coupon Bonds (debt instruments that do not require any interest payments until maturity). A Bond's OID is the excess of the stated redemption price at maturity over the issue price.[23] The stated redemption price at maturity is often equal to the Bond's stated principal amount (often known as its face amount or par value), but this is not necessarily the case. Federal tax rules define the stated redemption price at maturity as all payments provided by the obligation other than QSI.[24] As noted above, QSI is interest that is unconditionally payable (in cash or other property other than debt of the issuer) annually or more frequently over the term of the Bond at a fixed or qualified variable rate.

Holders of OID Bonds generally must accrue OID each year into income for federal income tax purposes, applying the constant interest rate method of accrual (also known as the constant yield method).[25] This is true regardless of whether the Bond holder uses an overall cash or accrual method of accounting.[26] The accrued OID is ordinary interest income.[27] The Bond holder's tax basis in the Bond is increased by the amount of accrued OID included in the Bond holder's income.[28]

18 Section 171(a)(1), Reg. section 1.171-2(a)(4)(i)(A).

19 Id.

20 Reg. sections 1.171-2(a)(4)(i)(B) and -2(a)(4)(i)(C).

21 Section 171(b)(1), Reg. section 1.171-1(e)(1)(iii).

22 Reg. section 1.171-3.

23 Section 1273(a)(1).

24 Section 1273(a)(2), Reg. section 1.1273-1(b).

25 Sections 1272(a)(1), 1272(a)(3), Reg. sections 1.1272-1(a), -1(b).

26 Section 1272(a)(1), Reg. section 1.1272-1(a).

27 Reg. section 1.1272-1(a).

28 Section 1272(d)(2), Reg. section 1.1272-1(g).

The bond premium rules apply to OID Bonds in the same manner as they apply to Bonds without OID. There is an additional set of premium rules, the acquisition premium rules, that may apply to OID Bonds but do not apply to Bonds without OID. The purchase of an OID Bond carries acquisition premium if the purchase price is (a) greater than the Bond's adjusted issue price, but (b) less than or equal to the sum of all remaining payments excluding QSI.[29] Acquisition premium must be amortized as an offset to OID income — either using a fractional method (the default method) or by using the constant yield method (if the taxpayer elects to do so, however, this requires electing to treat all interest, including QSI, market discount, OID and *de minimis* OID as OID).[30] The acquisition premium rules do not apply to Bonds purchased with bond premium.[31] Bond purchases with acquisition premium occur less frequently than purchases with bond premium or market discount.

Questions regarding a taxpayer's OID bonds and acquisition premium

The following questions are intended to assist you on an annual basis in accounting for OID income.

1. **Does the taxpayer's investment portfolio include Bonds?**
   a. If no, you need not answer the remaining questions. However, the taxpayer's portfolio may need to be reviewed each year to answer this question
   b. If yes, see question 2.

2. **Did any of the Bonds in the taxpayer's portfolio have OID?**
   a. If no, see the questions above related to Bonds purchased with bond premium and those below relating to Bonds purchased at a market discount.
   b. If yes, the taxpayer generally must report the amount of OID that accrued on the OID Bonds based on the constant yield method and include the accrued OID in income. This is true regardless of whether the OID Bonds are taxable or tax-exempt. The taxpayer's tax basis in the Bond is increased by the amount of OID included in income.[32] OID on tax-exempt Bonds is tax-exempt interest income.
   Be Aware: OID on tax-exempt Bonds may be includible in income for state income tax purposes.

3. **Did any of the OID Bonds in the taxpayer's portfolio have acquisition premium? (The purchase of an OID Bond carries acquisition premium if the purchase price is (a) greater than the Bond's adjusted issue price, but (b) less than or equal to the sum of all remaining payments excluding QSI.)**
   a. If no, see the questions above related to Bonds purchased with bond premium and those below relating to Bonds purchased at a market discount.
   b. If yes, acquisition premium must be amortized as an offset to OID income — either using a fractional method (the default method) or by using the constant yield method if the taxpayer (if the taxpayer elects to do so). The acquisition premium rules do not apply to Bonds purchased with bond premium. Brokers are required to report amortization of acquisition premium on Bonds acquired after Dec. 31, 2013, as well as adjust the cost basis for the related amortization.[33] Note: A broker cannot take the election to treat all interest as OID into account for Form 1099 reporting purposes for Bonds acquired after Dec. 31, 2014.[34] As a result, Bond holders who have made that election generally will report acquisition premium amounts that differ from amounts that may be shown on Forms 1099 they have received.
   c. Also consider the questions above related to Bonds purchased with bond premium and those below relating to Bonds purchased at a market discount.

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29 Section 1272(a)(7)(B)(i), Reg. section 1.272-2(b)(3).

30 Section 1272(a)(7), Reg. sections 1.1272-2(b)(4)-(5) and 1.1272-3.

31 The OID rules generally do not apply to bonds issued at a premium, see section 1272(c)(1), Reg. section 1.1272-2(a).

32 Reg. section 1.1272-1(g) (tax basis is increased by the amount of OID accrued in income and decreased by payments made to the holder other than payments of QSI). See also section 1288(a) (tax-exempt Bonds). For special basis rules applicable to pro rata prepayments, see Reg. section 1.1275-2(f).

33 Reg. sections 1.6049-9(c) and 1.6045-1(n)(7)(iii).

34 Id.

Market discount bonds and market discount accrual

The market discount rules address situations where a Bond holder has purchased a debt instrument after its initial issuance at a price that is less than the Bond's adjusted issue price (AIP). The market discount is the excess (if any) of the Bond's AIP over the purchase price.[35] A Bond's AIP is often equal to its stated principal amount (often known as its face amount or par value), but this is not necessarily the case. A Bond's AIP is its issue price on the day it was issued plus all accrued OID to date, minus all payments on the Bond to date, other than payments of QSI.[36]

For both tax-exempt and taxable Bonds, market discount is not includible in income by a taxpayer before the sale or disposition of the Bond (or receipt of a principal payment), unless an election is made to do so. The election to include market discount accrual in current income is addressed at the end of this section.

When a taxpayer sells or otherwise disposes of a market discount Bond, the gain generally is treated as ordinary interest income to the extent it does not exceed the accrued market discount at the date of disposition.[37] Receipt of a principal payment generally is treated as a disposition for this purpose.[38] Only gain in excess of the amount of the accrued market discount may be treated as capital gain where this rule applies.

Where there is a tax-free disposition of Bonds carrying market discount, such as an exchange of the Bond in certain types of corporate reorganizations, the ordinary income re-characterization potential inherent in the market discount generally is carried over in the property the taxpayer receives in exchange for the Bond.[39] In some circumstances, however, immediate recognition of the accrued market discount is required. This guide does not further address tax-free dispositions of market discount Bonds.

For market discount, the default rule is to accrue the discount using a ratable or straight-line method resulting in an equal amount of accrual annually while the taxpayer holds the Bond.[40] An alternative accrual method may be used: accruing the market discount using a constant interest rate method.[41] Use of the constant interest rate method results in accrual of less market discount in earlier years and more in later years as the Bond approaches maturity. In other words, market discount accrues more slowly using the constant interest method than it does using the ratable (straight-line) method. If the Bond is sold or otherwise disposed of prior to maturity, a taxpayer would recognize a lower amount of ordinary income if it elects to use the constant rate method than it would if it makes no election and uses the ratable method.

Deduction of interest paid or incurred to purchase or carry a market discount Bond generally is deferred to the extent of the accrued unrealized market discount on the Bond.[42] The deferred interest deductions generally are allowed later when the market discount is recognized.[43]

Under exceptions expressly provided in the Tax Code, the market discount rules do not apply to: (1) short-term instruments (instruments with a term of one year or less),[44] (2) United States savings bonds,[45] and (3) tax-exempt Bonds purchased before May 1, 1993.[46] There are other situations where the market discount rules may be inapplicable. For example, where the Bond holder has

35 Section 1278(a)(2).
36 Reg. sections 1.1275-1(b) (defining adjusted issue price) and 1.1273-1(c) (defining qualified stated interest).
37 Sections 1276(a)(1) (ordinary character) and 1276(a)(4) (treatment as interest for many (but not all) purposes under the Code).
38 Section 1276(a)(3)(A).
39 Section 1276(c).
40 Section 1276(b)(1).
41 Section 1276(b)(2).
42 Section 1277(a).
43 Section 1277(b)(2).
44 Section 1278(a)(1)(B)(i).
45 Section 1278(a)(1)(B)(ii).
46 Former section 1278(a)(1)(B), as in effect prior to the May 1, 1993, effective date of section 13206(b)(2)(a) of the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66).

acquired a Bond at a discount while the Bond is in default and full payment is due, applying the market discount rules would involve computing amortization by dividing the market discount by zero;[47] which mathematically cannot be done. This guide does not further address potential inapplicability of the market discount rules.

Questions regarding the election to accrue market discount using the constant interest rate method

The following questions are intended to assist you on an annual basis in determining if a need exists to consider making an election to accrue market discount on the constant interest rate method. The questions are intended to assist in considering and making the election to accrue discount on the constant interest rate method and include potential issues to be aware of with regard to market discount accrual reporting by brokers. A sample election statement is also included.

It is typically in a Bond holder's interest to elect to use the constant interest rate method of accruing market discount (rather than the default ratable method), because a Bond holder making the election generally would report less ordinary income and more capital gain upon a sale or disposition of the Bond at a gain prior to maturity.

1. **Does the taxpayer's investment portfolio include Bonds?**
   a. If no, you need not consider the remaining questions. However, the taxpayer's portfolio may need to be reviewed each year to answer this question.
   b. If yes, see question 2.

2. **Were any of the Bonds acquired at a market discount? The market discount is the excess (if any) of the Bond's AIP over its purchase price. A Bond's AIP is often equal to its stated principal amount (often known as its face amount or par value), but this is not necessarily the case.**
   a. If no, please see the questions above regarding bond premium and OID.
   b. If yes, the taxpayer generally must report any gain on the disposition of these Bonds as ordinary income up to the amount of accrued market discount at the disposition date. The taxpayer must use the ratable (straight-line) method for amortizing market discount unless it has elected to either: (a) use the constant interest rate (constant yield) method or (b) include market discount in income currently as it accrues.
   c. Brokers generally are required to report the annual accrual of market discount assuming that their customer elected to use the constant interest rate method if the Bond was acquired after Dec. 31, 2014.[48] This is true regardless of whether the taxpayer has elected to use the constant rate method or not. The broker's reporting, however, does not affect the taxpayer's elections. Adjustments may therefore be necessary to account for differences between the broker's assumptions and the customer's actual tax elections. However, a taxpayer may notify its broker in writing before the end of the calendar year that they are not making the constant interest rate method election and request that the ratable method continue to be used.[49] See question 5.

3. **What is the effect of making the election to accrue bond discount on the constant interest rate method?**
   a. Accruing market discount on the constant interest rate method results in lower accruals than the ratable method at first and greater accruals than the ratable method as the Bond approaches maturity.
   b. If the Bond is held to maturity and the Bond fully repaid, there is no difference in ordinary income recognition between the ratable and constant interest rate methods. However, if the Bond is sold at a gain prior to maturity, less ordinary income will be recognized using the constant interest rate method than the ratable method.

47 Section 1276(b)(1).

48 Reg. section 1.6045-1(n)(11)(i)(B).

49 Id.

c. The election can be made on a Bond-by-Bond basis or on a group basis.[50] Once made, the election is irrevocable.[51] This election should be considered each year for newly-acquired Bonds.

d. Next, see question 4.

4. **Does the taxpayer wish to make an election to accrue discount on the constant interest rate method?**

   a. If no, you must use the ratable method of accruing bond discount.
   Be aware: For market discount Bonds purchased after Dec. 31, 2014 (or a later date for some Bonds), brokers generally are required to report discount on those Bonds as though their customer has elected to accrue such discount using the constant interest rate method. This is true regardless of whether the customer made the election (except where the customer has timely notified the broker that they have not made the constant interest rate election for accruing market discount).
   Be further aware: Taxpayers cannot treat the discount as accrued using the constant interest rate method unless they have made the election to do so. The broker's reporting, however, does not affect the taxpayer's elections. Adjustments may therefore be necessary to account for differences between the broker's assumptions and the customer's actual tax elections. If the taxpayer has not made the constant interest rate election, the taxpayer must use the ratable method to accrue market discount.

   b. If yes, see question 5.

5. **The taxpayer has decided to elect to accrue market discount on the constant interest rate method. How do I make the election?**

   a. The election is made by attaching to the taxpayer's federal income tax return a statement identifying the Bond(s) to which the election applies.[52] This election may also be made for one or more specific Bonds, or for a class or group of Bonds. Making the election for a class or group of Bonds may be more efficient than preparing separate election statements for specific Bonds.
   See the sample section 1276(b)(2) election statements below.
   Be aware: The election must be made no later than the extended due date for the earliest tax year for which the taxpayer must determine market discount.[53] Once made, the election applies to all Bonds identified in the election by the taxpayer on the first day of the tax year for which it is made. The election may be made for a class or group of Bonds, so it will apply to all market discount Bonds acquired thereafter that are included in the class or group.

   b. Be aware: A *de minimis* rule applies if the market discount is less than 1/4 of 1 percent (0.25 percent) of the Bond's weighted average term to maturity (for Bonds with a principal amount payable only at maturity, this amount is the price payable at maturity multiplied by the number of complete years to maturity after the taxpayer acquires the Bond).[54] When the *de minimis* rule applies, there is no adjustment for accrued discount (as the market discount is deemed to be zero).

   c. For issues to watch for related to the accrual of market discount, see question 6.

6. **What are some issues you may encounter related to market discount accrual and suggested solutions?**

   a. Issue: Differences arising between Form 1099 reporting and required tax return reporting. For many Bonds acquired after Dec. 31, 2014, brokers generally report market discount accrual on the constant interest rate method regardless of whether the taxpayer has elected to do so. As gain on the sale of a market discount Bond is treated as ordinary income to the extent of the accrued discount, use of the accrual on the constant interest rate method without the election would result in a misreporting of the ordinary income.
   Recommendation: Check the detail on the Form 1099-B and any realized gain/loss statement provided by the broker to determine whether the broker used the same method

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50 Section 1276(b)(2)(A), Rev. Proc. 92-67, sections 4.02 and 5.

51 Section 1276(b)(2)(C).

52 Rev. Proc. 92-67, sections 4.02 and 5.

53 Rev. Proc. 92-67, sections 2.12, 3.01 and 4.01.

54 Section 1278(a)(2)(C).

that the taxpayer uses. If the taxpayer has decided not to elect use of the constant interest rate method, the broker should be notified to utilize the default ratable method to avoid potential misreporting issues.

Election to include market discount accrual in current income

An election is available to include market discount accrual in income each year.[55] The inclusion of accrued market discount in income often provides no benefit to taxpayers, as it requires them to pick up additional income annually in exchange for the potential of less ordinary income recognition upon sale or redemption. Taxpayers who may wish to discuss the possibility of making the election to include the accrued market discount in income could include those with net operating losses or unused investment interest expense carryovers. In such cases, the taxpayer may be able to offset the accelerated ordinary income resulting from the election with a loss or investment interest expense deduction.

Questions regarding the election to include accrued market discount in income each year

1. **Does the taxpayer's investment portfolio include Bonds?**
   a. If no, you need not consider remaining questions. However, the taxpayer's portfolio may need to be reviewed each year to answer this question
   b. If yes, see question 2.

2. **Were any of the Bonds acquired at a market discount? The market discount is the excess (if any) of the Bond's AIP over the purchase price. A Bond's AIP is often equal to its stated principal amount (often known as its face amount or par value), but this is not necessarily the case.**
   a. If no, see the questions related to Bonds issued or purchased on the secondary market at a premium on page 1.
   b. If yes, see question 3.

3. **What is the effect of making the election to include accrued market discount in current year income?**
   a. Absent any elections, each year a portion of the market discount is accrued on a ratable basis, but not included in income. By making the election, taxpayers must include the annual accrual as ordinary interest income.[56]
   Be aware: If the taxpayer has also made the election to accrue market discount on the constant interest rate method, the amount includible in income each year will not be based on the ratable amount.
   b. Upon including market discount accrual in income, the basis of the Bond must be adjusted to account for the amount included in income each year (accretion).[57]
   c. The adjustment to cost basis for the annual accrual of market discount acts to reduce the potential ordinary gain recognized upon redemption or sale at a gain.
   d. The overall effect is to accelerate potential ordinary gain on redemption or disposition in exchange for capital gain/loss treatment at redemption or sale (assuming a gain).
   e. The election is only revocable with consent of the IRS and the IRS has provided an automatic consent procedure for revoking the election.[58]

55 Section 1278(b).
56 Section 1278(b)(1)(B).
57 Section 1278(b)(4).
58 Rev. Proc. 2016-29, § 30.01.

Exhibit A: Sample statement regarding election to amortize bond premium

Statement Regarding the Taxpayer's Election to Amortize Bond Premium under Section 171(c)

Taxpayer Name:

Taxpayer Identification Number:

The taxpayer has elected on this tax return under section 171(c) of the Internal Revenue Code to amortize bond premium pursuant to Treasury Regulation section 1.171-4(a). The taxpayer has done so by offsetting amortization of bond premium against the qualified stated interest income from the applicable bond(s). Taxpayer is attaching this statement to the return as recommended by Treasury Regulation section 1.171-4(a).

Exhibit B: Sample election to use the constant interest rate method of accruing market discount for a single bond

Election to Use Constant Interest Rate Method under section 1276(b)(2) for One or More Specific Bonds

Taxpayer Name:

Taxpayer Identification Number:

Section 1276(b)(2) Election Statement

In accordance with Internal Revenue Code section 1276(b)(2) and Rev. Proc. 92-67, section 4, the taxpayer elects to use the constant interest rate method of accruing market discount on bonds. This election is effective for the following bonds:

Description(s) of Bond(s):

Date(s) Acquired:

Maturity Date:

Basis at Acquisition:

CUSIP Number If Applicable (optional):

Exhibit C: Sample election to use the constant interest rate method of accruing market discount for a group of bonds

Election to Use Constant Interest Rate Method under Section 1276(b)(2) for a Group of Bonds

Taxpayer Name:

Taxpayer Identification Number:

Section 1276(b)(2) Election Statement

In accordance with Internal Revenue Code section 1276(b)(2), and Rev. Proc. 92-67, section 5, the taxpayer elects to use the constant interest rate method of accruing market discount on bonds for the tax year ending (Month, Day, Year).

This election is effective for the following bonds:

[Describe the group(s) of Bonds. For example: all bonds issued at a market discount held in [Broker Name] account number [Account Number] (or successor account) or all bonds issued by [issuer name] and acquired by taxpayer.]

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Final Regulations on Issue Price Impose New Restrictions on the Offering and Sale of Tax-Exempt Bonds

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In December 2016, the U.S. Treasury Department issued Final Regulations (the "Final Regulations") on the determination of the issue price of certain types of tax-advantaged debt, including tax-exempt bonds,[1] for purposes of the arbitrage restrictions in Section 148 of the Internal Revenue Code of 1986, as amended (the "Code"). Effective for bonds sold on or after June 7, 2017, the Final Regulations replace Existing Regulations (the "Existing Regulations") that have been in effect for over 23 years. The Final Regulations impose new restrictions on the offering and sale of tax-exempt bonds and will raise a number of compliance questions.

Section 148 of the Code generally prohibits the investment of proceeds of a tax-exempt bond issue at a yield that materially exceeds the yield on the issue (the "bond yield"). In circumstances in which proceeds are permitted to be invested above the bond yield, Section 148 generally requires issuers to pay, or "rebate," the excess earnings to the federal government. For purposes of these arbitrage limits, the bond yield is computed based on the "issue price" of the bond issue. The determination of issue price is also important for sizing debt service reserve funds and certain other matters, as discussed below.

Existing Regulations

Since 1993, the Existing Regulations have provided that the issue price of bonds that are publicly offered is the first price at which a substantial amount (defined as 10%) of the bonds is sold to the public. For this purpose, the issue price of each maturity of substantially identical bonds is determined separately, and the "public" does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers. For bonds for which a bona fide public offering is made, the Existing Regulations provide that the issue price is determined as of the sale date (that is, the first day on which there is a binding contract in writing for the sale or exchange of the bonds) based on reasonable expectations regarding the initial public offering price. Thus, even if less than 10% of a maturity is in fact sold to the public at a particular price, under the Existing Regulations the issue price of that maturity will be its initial public offering price if the underwriter reasonably expected as of the sale date to sell the first 10% of the maturity to the public at such price.

[1] Tax-advantaged debt includes, in addition to tax-exempt bonds, new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds and qualified school construction bonds. For purposes of this alert, for ease of reference, we will use the term "tax-exempt," but the principles set forth would apply equally to other tax-advantaged debt.

Summary of Final Regulations

Three Alternative Rules. The Final Regulations provide three alternative rules that may apply to determine the issue price of tax-exempt bonds. Those rules are described below and are referred to herein, respectively, as the "10%" rule, the "hold-the-offering-price" rule, and the "three-bid competitive sale" rule. Only the first two of these rules is available with respect to bonds sold by negotiated sale.

1. General Rule: Sale of 10% of Bonds to the Public. Similar to the general rule in the Existing Regulations, the Final Regulations provide that, in general, the issue price of bonds issued for money is the first price at which a substantial amount (defined as 10%) of the bonds is sold to the public (the "10% rule"). For this purpose, issue price is determined separately for each maturity of bonds with the same credit and payment terms, and the "public" is defined as any person (that is, an individual, trust, estate, partnership, association, company, or corporation) other than an underwriter or a person related[2] to an underwriter. The Final Regulations define an "underwriter" as: (1) any person that agrees pursuant to a written contract with the issuer (or with the lead underwriter to form an underwriting syndicate) to participate in the initial sale of the bonds to the public; and (2) any person that agrees pursuant to a written contract directly or indirectly with a person described in clause (1) above to participate in the initial sale of the bonds to the public (for example, a retail distribution agreement between a national lead underwriter and a regional firm under which the regional firm participates in the initial sale of the bonds to the public).[3]

In a significant change from the Existing Regulations, the Final Regulations no longer provide (except in certain circumstances described below) that the issue price may be determined as of the sale date based on reasonable expectations regarding the initial public offering price. Rather, the Final Regulations provide that issuers may apply the "hold-the-offering-price" rule or, for bonds sold by competitive sale, the "three-bid competitive sale" rule to establish the issue price, as alternatives to the 10% rule.

2. Hold-the-Offering-Price Rule. The Final Regulations permit an issuer to treat the initial offering price to the public as the issue price of the bonds if the following requirements are met (the "hold-the-offering-price" rule):

> (1) the underwriter(s) offered the bonds to the public at a specified initial offering price on or before the sale date, and the lead (or sole) underwriter provides a certification to that effect, together with reasonable supporting documentation (such as the pricing wire); and

[2] In general, two or more persons are "related" for this purpose if they are connected through direct or indirect common ownership of more than 50%.

[3] Under the Final Regulations, a dealer that is not a party (or related to a party) to a contract directly or indirectly with the issuer or another dealer to participate in the initial sale of the bonds to the public (such as a bond purchase agreement, agreement among underwriters, selling group agreement, retail distribution agreement, notice of sale, or similar agreement) will constitute a member of the public. The Final Regulations provide more clarity on this question than the Existing Regulations, which do not contain a precise definition of "public" but rather state that the public does not include bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters or wholesalers.

(2) each underwriter[4] agrees in writing that it will neither offer nor sell the bonds to <u>any</u> person (including a related person) at a price higher[5] than the initial offering price during the period beginning on the sale date and ending on the earlier of (a) the close of the fifth business day[6] after the sale date, or (b) the date on which the underwriters have sold at least 10% of the bonds (of the particular maturity) to the public at a price no higher than the initial offering price (the "hold period").

3. <u>Three-Bid Competitive Sale Rule</u>. For bonds offered in a competitive sale, as described below, the Final Regulations permit an issuer to treat the reasonably expected initial offering price to the public as of the sale date as the issue price if the issuer obtains from the winning bidder a certification of that reasonably expected initial public offering price upon which the winning bid is based and the issuer receives at least three bids as described below (the "three-bid competitive sale" rule). A "competitive sale" is defined as a sale of bonds by an issuer to an underwriter that is the winning bidder in a bidding process that meets the following requirements:

(1) the issuer offers the bonds for sale to underwriters at specified written terms and disseminates the notice of sale to potential underwriters in a manner reasonably designed to reach potential underwriters (for example, through electronic communication that is widely circulated to potential underwriters by a recognized publisher of municipal bond offering documents or by posting on an Internet-based website or other electronic medium regularly used for such purpose and widely available to potential underwriters);

(2) all bidders have an equal opportunity to bid (for example, no bidders are given an exclusive "last look" to review other bids);

(3) the issuer <u>receives</u> bids from at least three underwriters who have established industry reputations for underwriting new municipal bond issuances; and

(4) the issuer awards the sale to the bidder who submits a firm offer to purchase the bonds at the highest price (or lowest interest cost).

<u>Choice of Rules</u>. An issuer will be permitted to apply a different rule to different maturities of the same issue. For example, an issuer may choose to apply the 10% rule to some maturities, and the hold-the-offering-price rule to others. The Final Regulations require an issuer

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[4] The definition of "underwriter" described above applies for purposes of this requirement. Thus, any person that agrees in a written contract directly or indirectly with the issuer or an underwriter to participate in the initial sale of the bonds to the public (including pursuant to a retail distribution agreement) must agree in writing to hold the offering price during the hold period in order for this rule to apply.

[5] A sale of bonds by an underwriter during the hold period to any person at a price that is at or lower than the initial offering price to the public will not violate the hold-the-offering price rule.

[6] The Final Regulations do not define the term "business day." Presumably, Saturdays, Sundays and federal holidays are not business days. In certain contexts unrelated to the determination of issue price, Treasury Regulations contain definitions of "business day" that exclude certain legal holidays in a state or the District of Columbia (see, for example, Treasury Regulations Section 301.6601-1 with respect to underpayments of tax and Treasury Regulations Section 31.3406(h)-1 regarding backup withholding). The Final Regulations do not incorporate any of those definitions and, thus, it may be necessary to consider on a case-by-case basis whether a particular non-federal holiday should be treated as a business day under the Final Regulations.

to identify in its books and records maintained for the bonds, on or before the issue date, which of the three rules (10%, hold-the-offering-price or three-bid competitive sale) it is applying to determine the issue price of bonds of the issue.

Private Placements. The Final Regulations provide that the issue price of bonds sold in a private placement to a single buyer that is not an underwriter or related to an underwriter is the price paid by that buyer.

Effective Date. The Final Regulations will apply to bonds sold on or after June 7, 2017. The Existing Regulations will continue to apply to bonds sold before that date.

Practical Considerations

Importance of Issue Price and Need for Certainty. The issue price of a tax-exempt bond issue generally must be determined in order for the issuer to comply with arbitrage restrictions, including investment yield limits, rebate requirements and limits on sizing debt service reserve funds. In addition to arbitrage restrictions, issue price must be established for issuers to comply with certain other federal tax requirements. For example, issue price is relevant to determine whether certain small issuers are eligible to designate bonds as "bank qualified" obligations, and whether certain tax-exempt private activity bonds satisfy volume cap, weighted average maturity and issuance cost limits. Although the Final Regulations technically apply only for arbitrage purposes, it is likely that, as a matter of practice, they will be applied for these other purposes in the absence of other guidance.

In some cases, it is critical for the issue price to be determined at the time the bonds are sold (that is, the first day on which there is a binding contract in writing for the sale or exchange of the bonds). For example, in an advance refunding[7] transaction, the issue price must be known in order to determine whether the bonds comply with yield restrictions imposed by federal tax law; namely, that the yield on the investments purchased with bond proceeds for the refunding escrow does not exceed the yield on the refunding bonds. Compliance with this yield restriction requirement must be established before an issuer can enter into a binding contract to sell advance refunding bonds on a tax-exempt basis. Similar considerations apply to bonds that fund a debt service reserve fund, bonds issued as "bank qualified" obligations, and tax-exempt private activity bonds subject to volume cap, weighted average maturity, and issuance cost limits.

Moreover, in nearly all transactions, the issue price ultimately must be determined to comply with Internal Revenue Service ("IRS") requirements. For example, issuers are required to report the issue price and bond yield on information returns filed with the IRS. In addition, bond counsel typically identify the issue price and bond yield in the bond documents signed at closing, in order to advise the issuer with respect to compliance with the Code and to set forth the issuer's reasonable expectations as generally required by the arbitrage regulations.

Under the 10% rule, the issue price of an issue will be established only if at least 10% of each maturity is actually sold to the public at a particular price. Under the Existing Regulations, the reasonable expectations standard allows the issue price to be determined with certainty, even

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[7] An "advance" refunding occurs if the refunded bonds are retired more than 90 days after the issue date of the refunding bonds.

if less than 10% of one or more maturities of an issue is sold to the public at a particular price. Under the Final Regulations, the reasonable expectations standard will no longer be generally available as a backstop for establishing the issue price of unsold maturities. Rather, issuers will need to rely on the hold-the-offering price rule or the three-bid competitive sale rule to determine the issue price of maturities that do not meet the 10% rule.[8]

Hold-the-Offering Price Rule. As noted above, an issuer will be able to treat the initial offering price to the public as the issue price of any bonds for which the hold-the-offering price rule is met. The hold-the-offering price rule will be met only if each underwriter agrees in writing that it will neither offer nor sell the bonds to any person during the hold period at a price higher than the initial offering price to the public.

Implementation of the hold-the-offering price rule will require amendments to various bond documents. For example, bond purchase agreements and agreements among underwriters will need to include procedures for identifying any maturities subject to the rule and specifying the applicable hold period, as well as covenants by the underwriters to comply with the rule. Selling group agreements and retail distribution agreements will need to contain similar provisions that restrict sales during the hold period by dealers and broker-dealers that are parties to such agreements. Issue price certificates will have to be revised to address the hold-the-offering price rule and other aspects of the Final Regulations. In addition, as discussed below, notices of sale for competitive offerings will need to address the hold-the-offering price rule if the issuer wishes to reserve the ability to apply it in the event less than three bids are received and the 10% rule is not met for all maturities. Industry groups are working on changes to model form documents to address these issues.

The hold-the-offering-price rule is likely to result in additional transaction costs and financing costs for issuers. In addition, the preamble to the Final Regulations states that an underwriter's breach of an agreement to comply with the hold-the-offering-price rule will result in a failure to establish issue price under that rule and a redetermination of issue price under a different rule.[9] Thus, a breach by an underwriter of its agreement to hold the offering price for the hold period could result in an assertion by the IRS that the issue price must be re-determined and, possibly, that such a redetermination would cause the bonds to fail to qualify for tax exemption.

[8] In theory, it may be possible to establish the issue price after the issue date under the 10% rule in certain transactions if the underwriters agree to monitor actual sales and report them to the issuer. However, such reliance on post-issuance monitoring could raise compliance problems. For example, if the underwriters failed to sell to the public (even after the issue date) at least 10% of any maturity at a particular price, the issue price (and therefore the bond yield) would not be determinable. Such a failure to establish the issue price could be problematic even if the issuer expected as of the issue date that there would be no gross proceeds of the issue subject to arbitrage limits. For example, a fixed-rate current refunding issue with no debt service reserve fund could become subject to yield restriction and rebate requirements if the issuer established a sinking fund or defeasance escrow for the issue after the issue date. Moreover, as discussed above, the IRS requires issuers to report the issue price and bond yield on information returns.

[9] More broadly, the preamble states that a failure to meet any specific eligibility requirement of a rule for determining issue price will result in a failure to establish issue price under that rule and a redetermination of issue price under a different rule.

Three-Bid Competitive Sale Rule. As indicated above, for bonds offered in a competitive sale that meets the three-bid competitive sale rule, the Final Regulations permit an issuer to treat the reasonably expected initial offering price to the public as of the sale date as the issue price. The preamble to the Final Regulations states that the Treasury Department and the IRS "recognize that competitive sales favor competition and price transparency that may result in better pricing for issuers."

For qualifying competitive sales, the three-bid competitive sale rule allows the issue price to be determined with certainty as of the sale date, even if less than 10% of one or more maturities is sold to the public at a particular price. On the other hand, if the issuer does not actually receive at least three bids, the three-bid competitive sale rule will not be available. Moreover, it is common in competitive sales to have unsold maturities for which the 10% rule will not be available.

To account for the possibility that it might not receive at least three bids, an issuer could include hold-the-offering-price restrictions in the notice of sale. Such restrictions could take effect, for example, if the issuer received fewer than three bids. However, any such restrictions would likely induce bidders to reduce the prices of their bids, thereby increasing the issuer's borrowing costs, and could even discourage potential bidders from submitting bids. A notice of sale might allow bidders to submit bids that may be withdrawn if (1) the issuer receives fewer than three bids, and (2) the issuer chooses to impose hold-the-offering-price restrictions. Alternatively, bidders might submit bids that (1) would be disregarded if three bids are not received, or (2) provide two alternative prices depending on whether three bids are received. There remains the question, however, continued to be analyzed by bond counsel, whether a revocable or conditional bid might not constitute a "firm" offer to purchase the bonds, as required by the three-bid competitive sale rule. Further, such type of bid process may raise questions about compliance with state and local bidding and procurement rules. In any event, a notice of sale could allow the issuer to reject all bids in the event three bids are not received, in which case the issuer could solicit bids for the bonds at a different time.

Conclusion

The Final Regulations, by eliminating the reasonable expectations backstop and adding the hold-the-offering price rule and the three-bid competitive sale rule, will significantly change longstanding practices for determining the issue price of tax-exempt bonds and will result in new restrictions on the offering and sale of those bonds.

IRS Updates Tax Rules Relating to Qualified Management Contracts

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On January 17, 2017, the IRS released Revenue Procedure 2017-13[1] ("Revenue Procedure 2017-13"), which provides guidance with respect to management contracts[2] related to property financed with certain types of tax-advantaged debt, including tax-exempt bonds.[3] Revenue Procedure 2017-13 modifies, amplifies, and supersedes the recently issued Revenue Procedure 2016-44,[4] which had modified and superseded prior guidance contained in Revenue Procedures 97-13 and 2001-39[5] and section 3.02 of Notice 2014-67[6]. The end result is that there will be one safe harbor found in Revenue Procedure 2017-13, with all prior management contract safe harbor guidance having been superseded.

Revenue Procedure 2017-13 provides new safe harbor conditions for management contracts which, if satisfied, will assure that the contract does not create private business use under sections 141 and 145 of the Internal Revenue Code of 1986 (the "Code").[7] Having more than a de minimis amount of private business use may disqualify bonds from being tax-exempt. This article discusses Revenue Procedure 2017-13 specifically in the context of healthcare financings.

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[1] 2017-6 I.R.B. 787.

[2] Management contracts generally include service contracts and incentive payment contracts. Management contracts that are properly treated as leases for federal income tax purposes are not subject to this guidance.

[3] Tax-advantaged debt includes, in addition to tax-exempt bonds, outstanding build America bonds and other governmental tax credit bonds. For purposes of this article and for ease of reference, the authors will use the term "tax-exempt bonds," but the principles set forth would apply equally to other tax-advantaged debt.

[4] 2016-36 I.R.B. 1. Revenue Procedure 2017-13 made four significant modifications to Revenue Procedure 2016-44, related to approval of certain types of compensation, the timing of payment of compensation, the treatment of land, and methods of approving rates. These modifications are encompassed in the discussion of the new safe harbor that follows.

[5] Revenue Procedure 97-13, 1997-1 C.B. 632, as originally issued, specified various permitted terms of contracts that depend on the nature of the compensation, including the extent to which the compensation is a periodic fixed fee. The greater the percentage of fixed compensation, the longer the permitted term of the management contract. Revenue Procedure 2001-39, 2001-2 C.B. 38, made only a minor amendment to Revenue Procedure 97-13 allowing for automatic increases in set fees according to specified, objective, external standards.

[6] Section 3.02 of Notice 2014-67, 2014-46 I.R.B. 822, expanded the Revenue Procedure 97-13 safe harbor to address certain developments involving accountable care organizations after the enactment of the Patient Protection and Affordable Care Act, Pub. L. 111-148, 124 Stat. 119, and also to allow a broader range of variable compensation arrangements for shorter-term management contracts of up to five years. The remainder of Notice 2014-67, which sets forth circumstances under which participation in the Medicare Shared Savings Program through an accountable care organization will not in itself result in private business use of the healthcare organization's tax-exempt bond-financed facilities, is not modified or superseded by Revenue Procedure 2017-13 and remains in effect.

[7] Revenue Procedure 2017-13 also creates a category of contracts called eligible expense reimbursement arrangements. If the conditions for this category are satisfied, the arrangement will not give rise to private business use.

Certain types of tax-exempt bonds (including qualified 501(c)(3) bonds, which are issued for many nonprofit healthcare systems) are subject to a limitation on the amount of private business use of financed facilities. Private business use may result from certain types of management contracts relating to bond-financed facilities. Until now, issuers of tax-exempt bonds and conduit borrowers such as healthcare systems have relied on the safe harbor conditions in Revenue Procedures 97-13 and 2001-39 and, more recently, Notice 2014-67 (collectively, the "Original Safe Harbors") to ensure that management contracts entered into with respect to financed property do not result in private business use. Revenue Procedure 97-13, however, was somewhat constraining, resulting in significant efforts to conform the normal commercial practices of the nongovernmental service provider to noncommercial constraints regarding compensation, reimbursement of nongovernmental expenses and term of the service arrangement.

Healthcare organizations have typically utilized relatively short-term contracts, particularly with respect to contracts with physicians and medical practices. Such short duration has typically allowed for maximum flexibility in compensation under Revenue Procedure 97-13. Even with the shortest term contracts there were difficulties meeting the requirements of Revenue Procedure 97-13. For example, requirements under Revenue Procedure 97-13 to include fee schedules for per-unit fee contracts presented commercial difficulties with physician group contracts, which were often structured as separate billing arrangements without specific fees enumerated in the contract. Notice 2014-67 removed some of Revenue Procedure 97-13's constraints by allowing contracts with any combination of compensation with a term of up to five years so long as there was no sharing of the net profits of the bond-financed facility. Five years, however, was thought not to be long enough by governmental issuers that desired long-term arrangements with respect to long-lived infrastructure projects. In response, the IRS issued Revenue Procedure 2016-44 and, in January, Revenue Procedure 2017-13, which, as described below, provide for a longer maximum contract term, but with certain additional requirements.

Under the new framework set forth in Revenue Procedure 2017-13, all management contracts, no matter the term, must satisfy a uniform set of requirements in order to qualify for the safe harbor. This new framework provides much needed relief for activities that need very long-term management contracts such as the construction and operation of toll roads. However, there are now additional conditions that must be taken into account, and some of these new requirements, discussed in more detail below, will require changes to the traditional forms of management contracts used by healthcare organizations.

The new management contract safe harbor provided under Revenue Procedure 2017-13 generally allows for fixed or variable compensation that is determined to be reasonable for services rendered under the contracts. As under the Original Safe Harbors and applicable regulations, the sharing of net profits from operation of the bond-financed facility is still not permitted, but now with a renewed focus on prohibiting the sharing of net losses as well. Revenue Procedure 2017-13 applies a principles-based approach focusing on (i) the extent of governmental control over the financed property; (ii) the extent to which the service provider does (or does not) bear risk of loss with respect to the financed property; (iii) the term of the arrangement in comparison to the economic life of the financed property; and (iv) consistency of tax positions taken by the service provider.

Revenue Procedure 2017-13 generally applies to any management contract that is entered into on or after August 22, 2016. However, an issuer may continue to rely upon the Original Safe Harbors in evaluating any agreement entered into prior to August 18, 2017, that is not materially modified or extended after that date (other than pursuant to a renewal option under which a party to the contract has a legally enforceable right to renew the contract). Conversely, an issuer, if it wanted to, is permitted to apply the new Revenue Procedure 2017-13 safe harbor conditions to any management contract that was entered into before August 22, 2016. As noted above, given that many management contracts with healthcare service providers are short-term in nature and were structured to qualify for favorable treatment under the Original Safe Harbors (and may not currently be structured to satisfy the additional requirements of the new safe harbor), it may be advantageous to keep these contracts grandfathered and not elect to have the new guidance apply to them. All contracts, however, should be reviewed on a case-by-case basis before making such a blanket determination. Any contracts entered into, materially modified or extended (other than pursuant to a legally enforceable renewal right)[8] after August 18, 2017, must satisfy the requirements of Revenue Procedure 2017-13 in order to qualify for the new safe harbor; as such, healthcare systems should review and update any management contract templates to conform to the new safe harbor.

Eight Safe Harbor Conditions under Revenue Procedure 2017-13

Under Revenue Procedure 2017-13, a management contract must satisfy certain conditions in order to qualify for the safe harbor and ensure that such contract does not result in private business use under sections 141 or 145 of the Code.[9] Below is a discussion of the eight conditions along with commentary specific to healthcare-related contracts.

1. **Compensation must be reasonable for services rendered during the term of the contract**. Reasonable compensation has always been required under the Original Safe Harbors. However, compensation for such purposes is now defined to include payments to reimburse actual and direct expenses paid by the service provider and related administrative overhead expenses of the service provider. *Nonprofit healthcare systems that are exempt from taxation under Section 501(c)(3) of the Code are generally already subject to a requirement that compensation be reasonable, as unreasonable compensation may result in impermissible private inurement or private benefit. This requirement raises the concern as to what type of evidence will need to be established to support a finding of reasonableness with respect to physician and practice group contracts. For example, in determining fees for specific physician services, should such*

[8] Note that it is unclear whether a contract with an "evergreen" renewal clause would be grandfathered. Given this uncertainty, and, as discussed below, the fact that such contracts as currently structured almost certainly will not satisfy all the requirements of the new guidance, it may be prudent to treat such contracts as subject to Revenue Procedure 2017-13 following the first extension on or after August 18, 2017.

[9] For purposes of Revenue Procedure 2017-13, a "management contract" means a management, service or incentive payment contract between a qualified user and a service provider under which the service provider provides services for a "managed property." A "service provider" means any person (other than another qualified user) that provides services to, or for the benefit of, a qualified user under a management contract. The term "qualified user" means, for projects financed with governmental bonds, any governmental person and, for projects financed with qualified 501(c)(3) bonds, any governmental person and any 501(c)(3) organization with respect to its activities that do not constitute an unrelated trade or business, determined by applying section 513(a) of the Code.

fees be based on schedules provided by unrelated third parties and any increases in such fees be tied to a specified, objective, external standard such as the Consumer Price Index? Revenue Procedure 2017-13 provides helpful guidance when explaining the control requirement, discussed below, by noting that such requirement may be satisfied "by requiring the service provider to charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party (such as a medical insurance company)."

2. **Contract must not provide the service provider a share of the net profits from the operation of the managed property**. As a safe harbor, a compensation arrangement will not be treated as a sharing of net profits if no element of the compensation for services takes into account or is contingent upon either the managed property's net profits or both the managed property's revenues and expenses for any fiscal period. For such purposes, the "elements" of compensation are: (i) eligibility for compensation; (ii) amount of compensation; and (iii) timing of compensation. Solely for the purpose of evaluating whether the amount of compensation (element (ii)) "takes into account, or is contingent upon, either the managed property's net profits or both the managed property's revenues and expenses for any fiscal period," any reimbursement of actual and direct expenses paid by the service provider to "unrelated parties" is disregarded as compensation.[10] As an example of application of this safe harbor, a compensation arrangement that provides for incentive bonuses for reaching targeted quality, performance or productivity goals in the service provider's operation of the managed property will not (in and of itself) be treated as providing the service provider a share of the net profits from the operation of the managed property. Certain types of management fees are not considered to be net profits arrangements. These arrangements include capitation fees, periodic fixed fees, per-unit fees,[11] and incentive fees based on certain performance metrics. Finally, Revenue Procedure 2017-13 clarifies that the deferral of compensation due to insufficient cash flow from the operation of the managed property will not cause the compensation to be treated as contingent upon net profits or net losses if it is payable annually, there are reasonable consequences for late payment (such as interest charges or late payment fees) and the contract includes a requirement that the qualified user will pay the deferred compensation within five years of the original due date of the payment. *It is important to remember that although the new safe harbor allows for more flexibility with respect to terms of contracts and variable compensation, an arrangement (such as a patient food services contract or a physician contract) with compensation based both on revenues and expenses of the financed facility may result in private business use. Note also that contracts that provide for compensation based on a share of gross revenues, which were generally protected under the Original Safe*

[10] For purposes of Revenue Procedure 2017-13, the term "unrelated party" means a person other than a related party (as defined in Treas. Reg. § 1.150-1(b)) or a service provider's employee. This represents a major change from the IRS's previous position evidenced in a private letter ruling that had treated a service provider's employees as unrelated parties for such purposes. Thus, for example, an arrangement which includes reimbursement of a service provider's onsite employee expenses (a common provision in many management contracts, including patient food service contracts) must now be reviewed to determine whether such arrangement provides for compensation based on both the revenues and expenses of operation of the managed property.

[11] Revenue Procedure 2017-13 provides that separate billing arrangements between physicians and hospitals are treated as per-unit fee arrangements.

Harbors, are not automatically protected under the new safe harbor. Thus, it is important that such arrangements be closely reviewed to ensure they do not give rise to private business use, particularly if coupled with the reimbursement of the service provider's employee expenses. Additionally, it may be useful to examine closely the nature of the expenses the service provider is obligated to pay. For example, the payment by the service provider of its own "internal" costs – e.g., supplies, service provider personnel costs, telephone and its own IT – may not be thought of as giving rise to a sharing of net profits, even when coupled with compensation to the service provider in whole or in part based on gross revenues. On the other hand, to the extent the service provider is obligated to bear any "plant-related" expenses – e.g., maintenance, HVAC, the cost of insuring the property – the risk of charactering the arrangement as a sharing of profits relating to the operation of the property may increase.

3. **Contract must not, in substance, impose upon the service provider the burden of bearing any share of net losses from the operation of the managed property**. As in the case of net profits, above, as a safe harbor, an arrangement will not be treated as shifting the burden of bearing a share of net losses if (i) the amount of compensation and unreimbursed expenses of the service provider does not take into account either the net losses of the managed property or both the revenues and expenses of the managed property for any fiscal year, and (ii) the timing of payment of compensation is not contingent upon the net losses of the managed property. Similar to the net profits prohibition above, the reimbursement of third-party costs is generally ignored, and management fees that are based on capitation fees, periodic fixed fees, and per-unit fees are not considered to be net loss arrangements. Further, as discussed above, the deferral of compensation due to insufficient cash flow will not cause the compensation to be treated as contingent on net losses if the compensation is payable annually, there are reasonable consequences for late payment (such as interest charges or late payment fees), and the contract includes a requirement that the qualified user will pay the deferred compensation within five years of the original due date of the payment.

4. **Term of contract (including all legally enforceable renewal options) must not exceed the lesser of 30 years or 80% of the weighted average reasonably expected economic life of property**. For this purpose, "economic life" is determined in the same manner as under section 147(b) of the Code. Under existing law, as a safe harbor with respect to the economic life of acquired or improved property, its midpoint life under the asset depreciation range system in effect in 1984 may be applied.[12] For purposes of measuring the weighted average reasonably expected economic life of property, land will be disregarded unless 25 percent or more of the net proceeds of the issue that finances the managed property is used to finance land, in which case the land is treated as having an economic life of 30 years. *As noted above, although this expansion of time periods is of great benefit to certain industries, it may have limited effect on healthcare-related management contracts, which for commercial reasons are generally of much shorter*

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[12] *See* Revenue Procedure 83-35, 1983-1 CB 745. For buildings, the asset guideline lives under Revenue Procedure 62-21, 1962-2 CB 418, may be used. As an alternative, economic life may be established under section 147(b) through the expert opinion of a licensed engineer or other professional, and usually is based upon industry experience with the particular type of property and familiarity with the maintenance practices of the owner of the property.

duration. However, the short-term nature of such contracts suggests more frequent testing dates for satisfying this requirement. Care should be taken toward the end of the economic life of the managed property to ensure that the term of any new or renewed management contract meets the requirement of the safe harbor. Contracts entered into when little economic life remains on the managed property may not qualify for the safe harbor.

5. **Qualified user must exercise a significant degree of control over managed property**. This requirement will be met if the contract requires that the qualified user approve the annual budget of the managed property, capital expenditures with respect to the managed property, each disposition of property that is part of the managed property, rates charged for the use of the managed property and the general nature and type of use of the managed property. Revenue Procedure 2017-13 clarifies that a qualified user may satisfy the approval of rates requirement by approving a reasonable general description of the method used to set the rates or by requiring that the service provider charge rates that are reasonable and customary as specifically determined by, or negotiated with, an independent third party (such as a medical insurance company). For example, this condition may be met through approval of an annual budget that includes the operating budget, approval of a capital expenditure budget (by functional purpose and specified maximum amounts), an authorization of dispositions of property, and approval of the methodology for the setting of rates (or requiring that rates be reasonable and customary as specifically determined by an independent third party) for the use of the managed property. *This is a new requirement that did not exist under the Original Safe Harbors. Management contracts that are entered into, extended or materially modified after the effective date should be closely examined to ensure compliance with this requirement. For example, under separate billing arrangements with physicians and under patient food services contracts, healthcare organizations often cede control over rates charged for the use of managed property to the service provider. Under the new safe harbor, either the healthcare organization must expressly approve such rates or the methodology for setting such rates, or the contract must include a requirement that the service provider charge customary and reasonable rates as specifically determined by an independent third party. This requirement may create a trap for the unwary.*

6. **Qualified user must bear the risk of loss upon damage or destruction of the property.** This requirement may be satisfied notwithstanding that the qualified user insures the property through a third party or, under the contract, imposes upon the service provider a penalty for failure to operate managed property in accordance with standards set forth in the contract.

7. **Service provider must agree that it is not entitled to and will not take any tax position inconsistent with being a service provider to the qualified user.** The contract must include an express written undertaking by the service provider not to take depreciation or amortization, investment tax credits, or deduction for any payment as "rent" with respect to the managed property. While as a practical matter a service provider under a management contract satisfying the Original Safe Harbors likely would not have been able to take a return position that it had an adequate ownership interest to support credits, depreciation or rental deductions, an express contractual covenant is one of the conditions to the Revenue Procedure 2017-13 safe harbor. *Many healthcare*

management contracts likely do not currently contain such explicit language. In order to continue qualifying for the safe harbor, such language will need to be added to these contracts at the time they are otherwise extended or materially modified. This requirement is another potential trap for the unwary.

8. **Service provider must not have any role or relationship with the qualified user that would restrict the exercise by the qualified user of its rights under the contract**. As a safe harbor, this condition will not be violated if: (i) no more than 20% of the voting power of the qualified user is vested in directors, officers, shareholders, partners, members, or employees of the service provider (or of any person related to the service provider); (ii) neither the service provider's chief executive officer (or person with similar management responsibilities) (the "CEO") nor the chairperson of the service provider's governing board is a member of the governing board of the qualified user; and (iii) the CEO of the service provider (or of any person related to the service provider) is not also the CEO of the qualified user or any person related to the qualified user. *As under Revenue Procedure 97-13, this requirement may prove difficult to meet in certain situations in which the service provider is a joint venture involving the exempt health care provider, such as a hospital/physician joint venture. However, if the qualified user has a controlling majority interest in the service provider, one may be able to conclude, consistent with prior private letter rulings issued by the IRS, that, although this "safe harbor" within the overall safe harbor is not itself satisfied, the service provider does not have a role or relationship with the qualified user that would restrict the exercise by the qualified user of the rights the qualified user has under the contract. This provision was much more relevant under the Original Safe Harbors because it was important for the qualified user to be able to terminate the contract, without cause or penalty, at a certain point in time during the term of a contract.*

Furthermore, a service provider's use of a project that is functionally related and subordinate to its performance under a management contract meeting all of the conditions above does not result in private business use.

Eligible Expense Reimbursement Arrangement

If a management contract is an "eligible expense reimbursement arrangement," such management contract does not result in private business use under Sections 141 and 145 of the Code. An "eligible expense reimbursement arrangement" is a management contract under which the compensation consists only of reimbursements of actual and direct expenses paid by the service provider to unrelated parties and reasonable related administrative overhead expenses of the service provider.[13] *This type of arrangement may have limited applicability in the healthcare context.*

[13] Under the Original Safe Harbors, contracts that provided only for reimbursement of actual and direct expenses paid by the service provider to unrelated parties did not result in private business use, but contracts (other than those related to public utility property) that provided for reimbursement of administrative overhead expenses were subject to the general rules of the Original Safe Harbors and could result in private business use.

But I Don't Owe This!
Personal Liability for Sales Tax Debts of a Business

by Jimmy Martens & Katie Wolters
with Martens, Todd, Leonard & Ahlrich

Bill Moore walks into your office and hires you to defend a lawsuit. The State of Texas has sued him personally, seeking to recover over $500,000 in sales taxes, penalties, and interest supposedly owed by Coastal Furnishings, Inc., a corporation for which he served as CFO.

Bill explains that Coastal Furnishings was a specialty furniture store that enjoyed great success until sales began to slump in 2010, when the business had to close its doors. At the end of 2010, Coastal Furnishings filed for bankruptcy. A bankruptcy trustee was in charge of administering the bankruptcy estate.

Bill shows you the assessment certificate attached to the State's petition, and you notice that the sales tax liability period spanned 2011-2014, which is ***after*** the business closed its doors. Bill also shows you a letter from the State dated July 1, 2011, notifying Coastal Furnishings of its failure to file its 2011 Texas franchise tax report. You learn that Coastal Furnishings failed to file its 2011 report when due on May 15, 2011, but the bankruptcy trustee filed the report exactly one year later, on May 15, 2012.

You immediately file a Texas Open Records Act (TORA) request to learn more about the assessment. The TORA response shows that in 2015, the Comptroller's auditor went to Coastal Furnishings' former location and saw that the business was gone. Following agency procedure, the auditor created an estimated assessment using a number of presumptions.

To generate the estimated assessment, the auditor first reviewed Coastal Furnishings' prior sales tax returns to determine the company's highest monthly sales figure, shown on Coastal Furnishings' sales tax report filed for September of 2009 when business was still booming. The auditor then presumed that Coastal Furnishings' sales had continued to increase in the following months, and multiplied the sales numbers for September of 2009 by 120%. The auditor then presumed that this level of sales had occurred each month of the three-year period spanning 2011-2014. The auditor further assumed that Coastal Furnishings had collected taxes at 8.25% on these estimated sales and failed to pay them over to the Comptroller.

Based on this estimate, the auditor prepared an assessment notice for $300,000 in sales tax, $150,000 in penalty (for failing to pay the $300,000 to the Comptroller) and another $50,000 in interest. The total assessment for Coastal Furnishings was $500,000.

Once the assessment was complete, the auditor mailed the assessment notice to Coastal Furnishings' former location, as required by the rules. Since no one was there to receive the assessment notice, the 30-day period for challenging it lapsed. The assessment became final against Coastal Furnishings.

After the assessment became final against Coastal Furnishings, the Comptroller realized that both the company's assets and shareholders were gone and filed suit against Mr. Moore personally, demanding that he pay the full $500,000 plus attorney's fees.

As his attorney, what are your options when preparing a defense for Mr. Moore?

Challenging the Underlying Assessment

Can Mr. Moore directly lower the amount of the assessment by presenting proof that it is not owed? Technically, no.[1] However, our firm has found that the state's attorneys will often consider the defendant's evidence on this point. In one recent case, we were able to show that the alleged tax liability had, in fact, been fully paid by another individual. As a result, the state's attorney agreed to release our client from that assessment.

Moreover, as we discuss below, challenges to the underlying assessment are available as a defense to some of the laws invoked to impose personal liability.

Personal Liability

The Texas tax code contains numerous provisions that impose personal liability for a business's unpaid tax debts.

1. Failing to Pay Over Collected Taxes

Can the State hold Mr. Moore personally liable for the full $500,000 for failing to pay over collected taxes? Texas law imposes personal liability on the individual who collected the taxes when a business collects taxes but does not pay them over to the state.[2] Personal liability applies to any money represented to be a tax, as well as to penalties and interest. The provision also extends to persons serving in a controlling or supervisory role.[3]

First, whether Mr. Moore could be held personally liable depends on whether he had a controlling or supervisory role over the business's affairs. Anyone who supervises or controls the collection, accounting, or payment of a tax can be subject to personal liability.[4] This includes any directors, officers, or employees of a business who have *any* role in the company's financial affairs. Several factors determine whether Mr. Moore's role as CFO was sufficient to subject him to personal liability. Did he: (1) prepare tax returns, (2) sign tax returns, (3) have the authority to write checks on the corporation's account or accounts, (4) have the authority to enter into and/or approve contracts on behalf of the corporation, (5) have the authority to receive and disburse funds on behalf of the corporation, or (6) hold an ownership interest in the corporation? [5]

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[1] Comptroller Hearing No. 105,174 (STAR No. 201308771H) (August 29, 2013) (Petitioner's redetermination hearing is limited to issues of personal liability).
[2] *See generally* Tex. Tax Code § 111.016.
[3] *Id.*
[4] *See* Tex. Tax Code § 111.016(a).
[5] *See* Comptroller Hearing No. 40,180 (STAR No. 200303182H) (Mar. 19, 2003).

Mr. Moore was Coastal Furnishings' CFO before it went out of business. As CFO, he would have had control over the collection and accounting practices for the business. Based on this first part of the analysis, Mr. Moore is likely presumed to be personally liable for the full $500,000 assessment.

Second, whether Mr. Moore could be held personally liable also depends on whether the sales tax was actually collected from customers. To hold Mr. Moore personally liable, the State must prove the *actual amount* of taxes collected or received by Coastal Furnishings.[6] The State has the benefit of a legal presumption, which arises when a company files a tax report showing that tax is due. [7] In that instance, the law presumes that the company collected the tax due.[8]

In many cases, the Comptroller will also introduce invoices, receipts, and bank deposits as proof that a business actually collected tax from its customers. The Comptroller could use the business's tax reports and financial records as proof that a business failed to remit collected taxes.

Mr. Moore has some helpful defenses available. First, Coastal Furnishings never filed a tax report during the assessment period showing that tax was due. As a result, Mr. Moore does not have to overcome a presumption that tax was due. Second, Coastal Furnishings' financial records and invoices will support Mr. Moore's case. Mr. Moore can introduce financial records and invoices that show Coastal Furnishings did not charge or collect tax from customers during the assessment period.[9]

Further, Mr. Moore's personal liability is limited to the amount actually received or collected by Coastal Furnishings.[10] The State must prove the *extent* of Mr. Moore's liability and cannot simply rely on the amount stated in the tax assessment.[11] In Mr. Moore's case, the auditor estimated Coastal Furnishings' sales and issued a tax assessment notice. While this may be sufficient to establish a tax liability against Coastal Furnishings, it won't be sufficient to establish a tax liability against Mr. Moore. The State must prove the *actual amount* of tax collected by Coastal Furnishings, or the assessment against Mr. Moore must be removed.[12]

2. <u>Intentionally Failing to File a Report, Substantially Understating Tax & Records Misconduct</u>

Can the State hold Mr. Moore personally liable for the full $500,000 for intentionally failing to file a report, substantially understating tax, or records misconduct? Personal liability

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[6] *Id.*
[7] *See Khan v. State*, 2011 Tex. App. LEXIS 7270 (Tex. App.−Austin Aug. 31, 2011, no pet.) (mem. op.).
[8] *See* Tex. Tax Code § 111.016(a-1).
[9] *Id.*
[10] *See N.S. Sportswear v. State*, 819 S.W.2d 230 (Tex. App.−Austin 1991, no pet.); Comptroller Hearing No. 32,094 (STAR No. 9605H1418F01) (May 23, 1996).
[11] *See N.S. Sportswear v. State*, 819 S.W.2d 230 (Tex. App.−Austin 1991, no pet.) (Proof by means of the comptroller's certificates, of the full amount of the corporate tax liability, is insufficient); Comptroller Hearing No. 32,094 (STAR No. 9605H1418F01) (May 23, 1996) (No evidence was presented indicating how much tax Petitioner collected or received on behalf of the state).
[12] *See id.*

may arise under Texas law when a business intentionally fails to file a tax report, substantially understates tax on a filed report, or mishandles business records. In each of these circumstances, if an individual in a controlling or supervisory role takes any action that could be traced to a business' failure to file accurate tax reports, he or she may be held personally liable for the tax assessment against the business.[13] While the law states certain factors tending to show personal liability, Comptroller policy shows that alone, (1) the taxpayer's signature on company checks and franchise tax reports, or (2) the taxpayer's role as the sole officer in the company are insufficient to establish personal liability.[14] We discuss each below.

a. <u>Failing to File a Report</u>

Personal liability may arise when a business is due to file its sales tax report, but the individual responsible for the report intentionally does not file it.[15] In Mr. Moore's case, the State will argue that Coastal Furnishings' sales tax reports were due to be filed in each month during 2011-2014, but Mr. Moore intentionally chose not to file the reports. Because Mr. Moore is an officer of the former business, the State will assume that he was personally involved in the affairs of the business and prevented the report from being filed.

In defense, Mr. Moore should argue that his role as an officer, alone, is insufficient to establish personal liability for the tax assessment. Mr. Moore may also prove that the corporation conducted no business during the audit period using the corporation's financial records and bankruptcy schedules.

<u>b. Substantially Understating Tax</u>

Personal liability may also arise when a business files a sales tax report, but understates the tax by more than 25%.[16] For an individual to incur personal liability, the report must contain an intentionally false statement.[17]

This does not necessarily mean that a business must have malicious intent to commit fraud. In fact, many sales tax reports contain intentional misstatements arising in circumstances like Mr. Moore's. Often, businesses will divide the amount of taxes they collected during the month by 8.25% and report the resulting figure as both taxable and total sales. In doing so, a business can substantially understate their actual sales, unless all of their sales were taxable. Similar to failing to file a report, a person in a controlling or supervisory role may incur personal liability for a business' tax assessment if he or she takes any action that could be traced to a business' failure to file accurate tax reports.[18]

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[13] *See* Tex. Tax Code § 111.0611(a).
[14] *See generally* Comptroller Hearing No. 103,412 (STAR No. 201412027H) (Dec. 12, 2014); Comptroller Hearing No. 105,174 (Star No. 201308771H) (Aug. 29, 2013); Comptroller Hearing No. 111,012 (Star No. 201505214H) (May 6, 2015).
[15] *See* Tex. Tax Code § 111.0611(b)(2).
[16] *See* Tex. Tax Code § 111.0611(b)(3).
[17] *Id.*
[18] *See* Tex. Tax Code § 111.0611(a).

In defense, Mr. Moore should argue that no sales tax reports were filed by Coastal Furnishings during the assessment period.

c. Records Misconduct

Personal liability may also arise if an individual alters, hides, or destroys records with intent to affect an audit.[19] These types of actions are the hallmarks of tax fraud.

If Mr. Moore destroyed the corporation's records after learning of an audit, he may incur personal liability for the tax assessment against Coastal Furnishings.[20] However, there is no evidence of records misconduct in this scenario, so the State cannot impose personal liability on Mr. Moore for records misconduct.

d. The State Must Prove Mr. Moore's Liability

Fortunately for individuals, the State has the burden of proving personal liability in each of these three scenarios.[21] The State must establish that the individual is personally involved in the affairs of the business, and further, the State must present evidence demonstrating the extent of the individual's involvement in the administration of the company's financial activities.[22]

In addition, the State cannot immediately pursue an individual for a business's tax assessment. The Comptroller must first attempt to verify and secure unencumbered assets of the business before seeking to impose liability on an individual.[23] An individual's personal liability is limited to the amount that the tax assessment exceeds the business entity's assets.[24]

Unfortunately, in Mr. Moore's case, the State already knows Coastal Furnishings is defunct and has no assets.

3. Delinquent Franchise Tax

Can the State hold Mr. Moore personally liable for the full $500,000 due to delinquent franchise tax reports? Personal liability can also arise because Coastal Furnishings failed to file its 2011 Texas Franchise Tax report on time. This report was due on May 15, 2011, but wasn't filed until the following year when the bankruptcy trustee realized the error. Although the trustee attempted to promptly correct his filing error, his failure exposes Mr. Moore to liability for the sales taxes that accrued during the period of forfeiture.

Generally, officers and directors are not subject to personal liability for the company's debts because corporations have corporate privileges shielding individuals from personal liability. However, if a corporation fails to file a franchise tax report, then it may 'forfeit' its

[19] *See* Tex. Tax Code § 111.0611(b).
[20] *See* Tex. Tax Code § 111.0611(a).
[21] *See generally* Comptroller Hearing No. 105,174 (Star No. 201308771H) (Aug. 29, 2013) (Staff bears the burden of proving by clear and convincing evidence that the assessment of personal liability is warranted).
[22] *See* Comptroller Hearing No. 103,918 (STAR No. 201101980H) (Jan. 11, 2011).
[23] *See* Tex. Tax Code § 111.0611(c).
[24] *Id.*

corporate privileges, removing this shield to personal liability.[25] If a corporation forfeits its corporate privileges, then each director or officer of the company becomes personally liable for any debts the corporation incurs after the date the report or tax is filed.[26] This personal liability period ends once the company's corporate privileges are revived.[27]

Fortunately for Mr. Moore, corporate privileges are not forfeited the moment that the franchise tax report is due. Rather, corporate privileges are forfeited when:

- The corporation fails to file its franchise tax report within 45 days after the Comptroller mails notice of forfeiture,
- The corporation fails to pay the franchise tax shown on its report, along with any penalty within 45 days after the Comptroller sends notice, or
- The corporation does not allow the Comptroller to examine its records when requested to do so.[28]

Each circumstance of failure requires action by the Comptroller. In this case, the bankruptcy trustee for Coastal Furnishings filed the company's franchise tax report one year after the report was due. As a result, Mr. Moore and every other officer and director of Coastal Furnishings incurred personal liability for the sales tax accrued during the period of forfeiture.

This is bad news for Mr. Moore. He was subject to personal liability for any debts that Coastal Furnishings incurred during the one-year period of forfeiture. Unfortunately, the tax assessment period overlaps with the period of forfeiture, so Mr. Moore could be held liable for the portion of the $500,000 assessment attributable to the 2011-2012 year (during the period of forfeiture).

<u>But I don't owe this!</u>

At this point, Mr. Moore's best defense is to establish that the assessment against Coastal Furnishings is inaccurate. While Coastal Furnishings has lost its right to challenge the underlying assessment, Mr. Moore still has the opportunity to challenge his personal assessment. The State has the burden of proof to present evidence proving the extent of Mr. Moore's personal liability. In this case, the State's evidence will be weak because Coastal Furnishings did not charge or collect sales tax during the assessment period. Further, Coastal Furnishings did not file tax reports showing that tax was due, and there is no evidence that Mr. Moore engaged in any records misconduct.

Mr. Moore has the ability to challenge the State's contentions and present potential defenses. With careful strategy, Mr. Moore can present a strong case to overcome the State's claims and escape personal liability for the tax assessment.

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[25] *See* Tex. Tax Code § 171.251; Tex. Tax Code § 171.252.
[26] *See* Tex. Tax Code § 171.252(b).
[27] *See* Tex. Tax Code § 171.255(a).
[28] *See* Tex. Tax Code § 171.251.

DISC Dividends to Roth IRA Shareholders: How Taxpayers Strategically Used the Tax Code to Achieve Long-Term, Tax-Free Growth on Unlimited IRA Contributions

By: Alyca Riley and Jim Griffin
Jackson Walker LLP

On February 16, 2017, the Sixth Circuit Court of Appeals reversed a Tax Court decision that had given the Commissioner of the Internal Revenue Service nearly unfettered authority to use the "substance-over-form" doctrine to reclassify transactions that were authorized by the Internal Revenue Code but combined and used by taxpayers in a way that significantly reduced their tax liability. The Sixth Circuit concluded that because the taxpayers complied with the Code as it was written, the Commissioner could not broadly apply the substance-over-form doctrine to recharacterize the transaction by claiming that such a significant reduction in taxes violated the overarching principles of federal tax law.

The *Summa Holdings* case involved two tax-minimizing vehicles authorized by the Code: a "domestic international sales corporation" (commonly known as a "DISC") and a Roth Individual Retirement Account. By using both entities as part of their overall corporate tax structure and paying a one-time, high unrelated business income tax on the dividends from the DISC, the taxpayers achieved:

- a lower overall corporate tax rate on qualified export income,
- contributions of approximately $6 million dollars into two Roth IRAs over a six year span (with no regard to the contribution limitations typically associated with a Roth IRA), and
- potentially 80-100 years of tax-free investment growth in the Roth IRAs.

The Commissioner took the position that the tax benefits derived from combining the DISC and the Roth IRA were "too good to be true" and that the substance-over-form doctrine should be used to prevent such a result because this tactic was outside of the spirit of the law. The Court of Appeals however expressly held that the substance-over-form doctrine did not prevent the taxpayers from combining the two provisions to create an extremely tax-favorable result.

Often used in corporate tax planning, a DISC is an entity designed by Congress that allows a domestic corporation to reduce its corporate taxes on income from exports. Under the DISC rules, a corporation may reduce its revenue by paying "commissions" on qualified export income to a DISC. The DISC pays no tax on its receipt of the commissions, but its shareholders are taxed on any distribution from the DISC as a dividend, which is typically taxed at the lower qualified dividend tax rate of 20%. However, if the shareholder is an IRA or other tax exempt entity, it must pay an unrelated business income tax equal to the higher corporate rate (up to 35% under current law) upon distribution from the DISC. This additional tax is the one-time cost of allowing the IRA to own shares of the DISC and benefit from any dividends paid to the DISC shareholders.

For purposes of personal tax planning, a Roth IRA provides individuals with a tax-savings mechanism. Individuals may contribute after-tax dollars to a Roth retirement account, up to a maximum limit set by Congress each year (currently $5,500 per year). Any distributions from the Roth IRA, including growth and earnings on the initial contributions, are not subject to tax when distributed which allows for significant tax-free growth over a long period of time.

In this particular case, the Benensons, the owners of an international manufacturing company, formed a DISC that was wholly owned by JC Holding, a corporation with two 50% Roth IRA owners. The Benensons' manufacturing company, Summa Holdings, paid commissions to the DISC as provided for by the Code. The DISC distributed money as a dividend to JC Holding which paid the high unrelated business income tax on the dividend as provided for by the Code. JC Holding distributed the remaining after-tax funds to its two Roth IRA shareholders as dividends. Over a period of six years, the Roth IRAs had accumulated over 6 million dollars. As Roth IRA assets, the dividends could continue to grow tax-free until withdrawn by the owner of the account. Effectively, the Benensons had reduced their corporate income tax liability through the use of a DISC and had also reduced their individual tax liability by setting aside after-tax dollars that would continue to grow tax-free.

Although the Benensons complied with the relevant provisions of the Code, the Commissioner deemed the transfer a form of tax evasion. Relying on the substance-over-form doctrine, the Commissioner claimed that the commissions and dividends were, in substance, dividends to the Benensons as Summa Holdings shareholders (which should have been taxed) followed by contributions to the Roth IRAs (which should have been limited). The Benensons challenged the ruling in the Tax Court, but the Tax Court affirmed the Commissioner's actions.

The substance-over-form doctrine was created by the United States Supreme Court to allow the Commissioner to reclassify certain transactions in order to respect the overarching principles of the Code such that the economic substance of a transaction will outweigh the form of the transaction, if the two vary. The Court clarified in this case that the doctrine's applicability is limited. The doctrine was intended to reclassify sham transactions or those that are labeled one thing, but the label does not reflect the economic realities of the transaction. The Code itself creates opportunities for taxpayers to reduce their taxes. Thus, the Court reasoned that the doctrine cannot be used to reverse a transaction simply because it avoids or lessens a taxpayer's tax liability. Here, the form and economic substance of the transaction were allowed and contemplated under the Code: (1) Congress designed DISCs to defer corporate income tax on qualified exports and (2) Roth IRAs were designed for tax-reduction purposes and were allowed to be DISC shareholders. Therefore, the substance-over-form doctrine could not apply in this case.

The Court also rejected the Commissioner's argument that when two potential structures lead to the same end result, the Commissioner has the authority to require the taxpayer to use the higher-taxed option. The Court explained that taxpayers are entitled to use the tax reduction strategies provided by the Code to attain the lowest taxes possible. Citing Judge Learned Hand, the Court reminds us that "there is no 'patriotic duty to increase one's taxes.'"

The Sixth Circuit ultimately concluded that the Benensons complied with all of the requirements of the Code in the DISC-Roth IRA strategy and therefore upheld the transaction. In doing so, the Court has limited the IRS's use of the substance-over-form doctrine going forward and made clear that a broad application of the doctrine will not be tolerated.

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LEGAL INSIGHT

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Tax

Valero Refining-Texas, L.P. v. Galveston Central Appraisal District: A Strategic Opportunity?

By Cynthia M. Ohlenforst, Sam Megally, and William J. LeDoux

The Texas Supreme Court recently handed an owner of a Texas oil refinery a significant victory in *Valero Refining-Texas, L.P. v. Galveston Central Appraisal District*, No. 15-0492, 2017 WL 727276 (Tex. Feb. 24, 2017). In a suit relating to the 2011 tax year, Valero asserted that the Galveston Central Appraisal District (GCAD) had appraised its refinery unequally as compared to other refineries. GCAD had appraised various components of Valero's refinery in several separate tax accounts; Valero's challenge related to the appraisals of some, but not all, of those accounts. One of the issues was whether Valero was required to compare the entire value of its refinery to the entire value of other refineries in its unequal appraisal analysis. The Supreme Court concluded that, as a matter of law, Valero was entitled to limit its property tax suit to the selected tax accounts and the portions of its refinery to which they corresponded.

In its opinion, the Supreme Court focused on the practical effect of GCAD's having assigned the various parts of Valero's refinery to different tax accounts. The Court reasoned that because GCAD had discretion in determining how to appraise Valero's property, including by assigning it to various tax accounts, it could not argue that Valero's contest to the appraised value of some of those accounts was somehow deficient: "If component parts of a property cannot be valued in isolation, then as a matter of law, separate accounts are not appropriate. It follows that if tax accounts are appropriate, then as a matter of law, the property in each account can be valued in isolation. This is transposition logic, not a factual dispute."

The Supreme Court's decision is likely to give rise to strategic opportunities for both Texas property owners and appraisal districts. When considering whether to contest a property tax appraisal, property owners — including owners of refining and industrial facilities, power generation facilities, and other complex properties — should carefully analyze and consider how their properties are assigned to tax accounts, how the appraisal district assigns similar properties to tax accounts, and which tax accounts to challenge. Property owners should also be wary if an appraisal district re-assigns property among tax accounts and should carefully examine how such changes to their tax accounts may affect their ability to successfully contest future property tax appraisals. It is worth noting that, during the pendency of this case, GCAD changed its appraisal system to contain the entire value of Valero's refinery in a single account; it is possible that other appraisal districts could follow suit now that the Supreme Court has ruled in the property owner's favor in this case.

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QSEHRA, Sera: Small Employers Catch a Break from ACA Rules

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Overshadowed by the political drama surrounding the Affordable Care Act (ACA) is tax legislation enacted in December 2016 to make stand-alone health reimbursement arrangements (HRAs) available to employees of certain small employers. An HRA typically consists of an arrangement under which an employer makes nontaxable reimbursements of an employee's medical expenses up to a predetermined annual maximum. The Internal Revenue Service (IRS) had interpreted the ACA to prohibit an employer from offering any HRA to its active employees unless the HRA was "integrated" with an employer's group health plan complying with the ACA market reform requirements.[1] That interpretation deterred employers without group health plans from maintaining stand-alone HRAs to reimburse their employees for the cost of health insurance the employees purchased for themselves in the individual insurance market. The new legislation, called the 21st Century Cures Act,[2] has created a means for certain small employers to pay some of that cost on a tax-favored basis without tripping over the ACA restrictions on stand-alone HRAs.

The new legislation added Section 9831(d) to the Internal Revenue Code of 1986 (Code) effective generally for years beginning after December 31, 2016. Section 9831(d) refers to the new type of HRA as a "qualified small employer health reimbursement arrangement" (QSEHRA). A QSEHRA must meet the specific conditions described below.

The employer maintaining a QSEHRA must be one that is not an "applicable large employer" for purposes of the ACA employer mandate *and* does not offer a group health plan to any of its employees. An "applicable large employer" is defined in Section 4980H(c)(2) of the Code, with respect to a calendar year, as an employer that employs an average of at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year. Thus, a QSEHRA is restricted to an employer with fewer than 50 full-time employees, as determined under Section 4980H of the Code and its regulations, including its rules treating affiliated employers as a single employer under Section 414(b), (c), (m), or (o) of the Code.

A QSEHRA must be funded solely by the employer with no salary reduction contributions by employees. Upon an employee's proof of coverage, the arrangement provides for the payment or reimbursement of the employee's medical care (as defined in Section 213(d) of the Code) incurred by the employee or the employee's family members and substantiated. The maximum amount of payments and reimbursements for any year cannot exceed $4,950—or $10,000 in the case of an arrangement that also provides for payments or reimbursements

[1] Notice 2015-17, 2015-14 I.R.B. 845, and Notice 2013-54, 2013-40 I.R.B. 287.
[2] Pub. L. No. 114-255.

for family members of the employee. These dollar maximums are adjusted annually for inflation and prorated for coverage periods of less than a year.

A QSEHRA must be provided on the same terms to all eligible employees of the employer. All employees of the employer must be eligible with the exception of the following (who may be excluded): employees who have not completed 90 days of service, employees who have not attained age 25, part-time or seasonal employees, employees covered by a collective bargaining agreement if health benefits were the subject of good faith bargaining, and nonresident aliens with no earned income from sources within the United States. An arrangement does not fail to meet this "same terms" requirement merely because the employee's maximum benefit under the arrangement varies in accordance with the price of an insurance policy based on the number of family members the employee has covered under the arrangement and their ages.

Finally, an employer funding a QSEHRA for any year must provide a written notice to each eligible employee including prescribed information not later than 90 days before the beginning of the year, or in the case of an employee who is not eligible to participate in the arrangement as of the beginning of the year, the date on which the employee is first so eligible. The prescribed information includes (i) a statement of the amount which would be the eligible employee's maximum benefit available under the employer's QSEHRA for the year, not to exceed the dollar amounts described above, (ii) a statement that the employee should provide the information described in clause (i) to any health insurance exchange to which the employee applies for advance payment of the premium assistance tax credit, and (iii) a statement that if the employee is not covered under minimum essential coverage for any month, the employee may be subject to tax under Section 5000A of the Code for that month and reimbursements under the QSEHRA may be includible in gross income. New Section 6652(o) of the Code subjects the failure to provide this notice to a penalty of $50 per employee per failure, not to exceed $2,500 for all such failures during any calendar year. In addition, the employer is required to report the QSEHRA benefit on an eligible employee's Form W-2.

The IRS responded to the QSEHRA notice requirement with transition relief in Notice 2017-20.[3] According to that Notice, an employer that provides a QSEHRA to its eligible employees for a year beginning in 2017 is not required to furnish the initial written notice to those employees until after further guidance has been issued by the IRS. That further guidance will specify a deadline for providing the initial written notice that is no earlier than 90 days following the issuance of that guidance. No Section 6652(o) penalties will be imposed for failure to provide the initial written notice before the extended deadline specified in that guidance. It remains to be seen whether further guidance will include a model notice.

The new legislation exempts a QSEHRA from the mandates of the Employee Retirement Income Security Act of 1974 (ERISA) and the Public Health Service Act (PHSA) on group health plans, including the ERISA and PHSA mandates for COBRA continuation coverage. Similarly, a

[3] 2017-11 I.R.B. 1010.

QSEHRA is not treated as a group health plan for purposes of the Code other than the "Cadillac" tax provisions of Section 4980I. However, the new legislation does not exempt a QSEHRA from the privacy and security requirements of the Health Insurance Portability and Accountability Act of 1996. Nor does it exempt a QSEHRA from the ERISA requirements applicable to an employee welfare benefit plan other than the group health plan requirements.

A small employer that does not offer its employees a group health plan now can offer them a QSEHRA to assist them on a tax-favored basis with paying their individual health insurance premiums, but the employer must be prepared to follow all the QSEHRA rules.

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April 11, 2017

State Bar of Texas, Tax Section
David E. Colmenero, Chair Via E-mail to: dcolmenero@meadowscollier.com
Sam Megally Via E-mail to: Sam.Megally@KLGates.com

Re: Comments and Agency Responses
Comptroller Rules 1.4, 1.8, 1.18, 1.28, 1.29, 1.32, and 1.41

Dear Sirs:

Thank you for the comments concerning our proposals relating to the Comptroller's Rules of Practice and Procedure. Below is a summary of your comments and our responses.

Rule 1.4 (Representation and Participation)

1. You ask whether the first sentence of subsection (a) is intended to pertain only to individual taxpayers. If so, you suggest additional language to make that more clear.

Response: We have edited subsection (a) in response to your comment.

2. You ask that subsection (a) clarify that individual taxpayers must authorize representatives in writing, just as legal entity taxpayers must do. You ask that Rule 1.4 include a clear statement that an individual taxpayer must make his or her designation by written authorization.

Response: We have edited subsection (a) in response to your comment.

3. You ask for a clear statement "whether a power of attorney -- for instance, one executed during an earlier audit that has given rise to a contested case -- remains a sufficient authorization ..." for the contested case. You advocate that the answer is yes.

Response: We have edited the rule in response to your comment. However, we disagree that it should state that a limited power of attorney submitted during an audit, before the contested case begins, overrides the taxpayer's representative for notice for the contested case. Section 1.4(b) explains that the designated representative for notice is the person that a taxpayer authorizes to sign its Statement of Grounds. Subsection (b) contemplates that the taxpayer's Statement of Grounds will be signed by a person designated by the taxpayer as the person who will receive notice of contested case documents, and this may be the same person the taxpayer authorized as its representative before the contested case began.

4. You state that you understand that a power of attorney form that satisfies Rule 1.4 may be promulgated. You ask that the rule refer to such a form and that the agency circulate to all interested parties a draft of such form prior to finalizing the rule and filing it with the Texas Register.

Response: We decline to add a specific reference to a form in Rule 1.4 for a power of attorney because the agency does not currently require a specific form, nor does the draft proposal require a specific form. However, the agency continues to work on updated power of attorney forms that will be made available as a convenience to taxpayers and their representatives. The forms will be circulated to the Taxpayer Advisory Group and the Business Advisory Group for comment separate from the adoption of these practice and procedure rules and we welcome your comments.

Rule 1.8 (Resolution Agreements)

1. You note that subsection (c)(1) refers to the requirement to use standard resolution agreement forms to memorialize an agreement. You note that the forms are not provided for review in conjunction with the draft rule that requires use of the forms. You suggest that we strike an explicit requirement in Rule 1.8 to begin with an approved form for a resolution agreement. You note that a form may be useful internally. You note that requiring the Comptroller's form by rule may discourage reasonable and necessary changes to the form that a taxpayer may request.

Response: We decline to edit subsection (c)(1) to incorporate your suggested edits. We have found that the use of standard resolution agreement terms promotes consistency and equal treatment in the administration of tax laws and rules. Standard resolution agreement terms and conditions also allow for consistent processing of adjusted liabilities or credits within the agency pursuant to the parties' agreement, while reducing the opportunities for mistakes. However, to preserve our ability to make slight changes to the standard agreement as may be appropriate in the future, we do not want to adopt a form by reference in the rule.

2. You believe that settlements may be discouraged by subsection (b)(4). You state that a settlement at the administrative level that precludes the issuance of a Comptroller's Decision will not be acceptable to taxpayers due to the subsequent inability of the taxpayer to file a motion for rehearing. As a solution, you request language that states that "a comptroller's decision may issue if agreed by all parties" or, alternatively, "a mechanism for the bifurcation of issues or periods into separate hearings so that contested issues do not block the parties' ability to resolve agreed issues."

Response: We decline to edit subsection (b)(4) to allow partial settlement, meaning both a decision and a resolution agreement dispose of the same contested case, for the following reasons.

First, both the existing language in Rule 1.8 and draft proposal Rule 1.8(b) refer to a resolution of "all contentions." The draft proposal for Rule 1.8, allowing resolution at any time before a decision becomes final, does not seek to change existing practice. As a result, the draft proposal contemplates that a contested case is resolved when "all contentions" are resolved.

Second, the process for a resolution agreement, which is the informal disposition of a contested case under Tex. Gov't Code § 2001.056, is much different from a Comptroller's Decision and the motion for rehearing process, which is a formal disposition of a contested case under Tex. Gov't Code §§ 2001.141-147. Informal disposition through a resolution agreement presumes "a resolution of all contentions," whatever the rationale. On the other hand, formal disposition presumes a notice of hearing that states unresolved contentions. In the context of a formal disposition, a party may complain about error in its exceptions to a proposal for decision. After a Comptroller's Decision on a proposal for decision, a party may complain about error in its motion for rehearing and seek a decision on rehearing.

Third, the agency's current practice encourages agreement and efficiency in the disposition of contested case issues. Partial agreements that resolve some, but not all, contested case issues are documented during the contested case process, and contested cases are resolved with documented agreed adjustments. If a case is formally disposed, agreed adjustments are included in the Notice of Hearing and it will identify the remaining issues to be resolved. The agency honors agreed adjustments in a motion to dismiss as well. For example, if a case is informally disposed of through a motion to dismiss for failure to reply to a position letter, then the agency's practice is to include the agreed adjustments that are presented in the position letter. Thus, agreed adjustments are included in a decision in a contested case.

Finally, the agency does not encourage bifurcation of a contested case because it does not promote efficiency and could lead to a proliferation of unresolved cases.

3. Relating to subsection (d), you ask for a clear statement of the procedure by which a taxpayer may request that their contested case be considered by the Comptroller's tax dispute office.

Response: We have edited the rule in response to your comment.

<u>Rule 1.18 (Filing Documents)</u>

1. Relating to documents filed by hand-delivery, you ask that draft subsection (e) read: "A document filed by hand-delivery is considered filed on the date received by staff at the agency's security desk."

Response: We have edited subsection (e) in response to your comment.

2. Relating to documents filed electronically, you ask that draft subsection (e) read: "A document that is filed electronically is considered filed on a date when it is received at any time during the 24-hour period from 12:00 a.m. (midnight) through 11:59 p.m. on

that date, and a document received on a day on which the agency is closed is considered filed on the next calendar day on which the agency is open."

Response: We have edited subsection (e) in response to your comment.

3. You ask that the proposed rule add a provision allowing a taxpayer to request documentation from the Comptroller demonstrating the date of receipt of a document by the Comptroller.

Response: We have edited subsection (e) in response to your comment. The agency's current process is to stamp or hand-write the date of receipt on all documents received from a taxpayer by hand-delivery, which includes a copy or copies provided by a courier to file-stamp and return to a taxpayer. Documents that a taxpayer files by mail are processed in the same manner with a file-stamp date received by the mailroom. Relating to documents filed electronically, the agency's server generates a transmission report that shows the actual date and time of receipt of the document filed with the Comptroller, as required by this chapter, through the Office of Special Counsel for Tax Hearings.

4. You ask that the proposed rule "explicitly provide" that, in the event the Comptroller cannot provide such documentation or such documentation is unclear, alternative probative evidence of the actual date of delivery shall be acceptable in determining the actual date of receipt by the Comptroller.

Response: We have edited subsection (e) in response to your comment. However, we decline to use the proposed language "if such documentation is unclear...." The standard of "unclear" is as uncertain and undefined as the word itself, and this is compounded by the omission of a process concerning who determines the clarity of the proof deemed unclear. We also decline to use the proposed language of a delivery date to indicate the actual date of receipt. The delivery date may not indicate the receipt date. For example, when a document is filed by mail, the date that a document is placed in, or actually delivered to, a drop box at a closed post office is not the date the Comptroller actually received the document. Another example, relating to a document filed by hand-delivery: if a document is placed at the entrance door to a closed state agency on a holiday, weekend, or similar day of closure, then the actual date of delivery is not the actual date of receipt of the filed document.

Rule 1.28 (Comptroller's Decision and Orders)

1. Relating to subsection (c)(3), you object to a subjective determination underlying a Comptroller's Decision on a motion to dismiss for failure to state a claim, and you request that subsection (c)(3) be struck altogether or amended to identify the circumstances in which such a motion to dismiss would be appropriate.

Response: We have edited the name of this type of motion to dismiss, relating to "failure to state a claim," in response to your comment. In addition, we relocated the topic of motions to dismiss in Rule 1.39 (Dismissal of Case).

2. You request a limit on the time to issue a Comptroller's Decision from the date of the proposal for decision. You state that the time from a proposal for decision to a decision can be extremely long. You state that delay can increase the amount of interest for which a taxpayer is liable. Specifically, you ask that Rule 1.28 include a standard timeframe, perhaps 90 days, after a proposal for decision is issued, in which the agency is required to issue a final decision. You propose an extension of a required timeframe to issue a decision, perhaps 45 days, subject to an explanation provided by the agency in a written submission to the taxpayer.

Response: We decline to edit the rule as requested to include a deadline by which the Comptroller must issue a decision, running from the date of a proposal for decision, for several reasons.

First, the Comptroller does not have jurisdiction to issue a decision beginning on the date a proposal for decision is issued; the parties may file exceptions and replies to a proposal for decision, and the ALJ may amend or correct a proposal for decision. Attachment B to each decision shows the date the Comptroller acquires jurisdiction of a case.

Second, the contested issues in each tax hearing vary in number and in complexity, and this is often reflected in the length of time needed to review each proposal for decision, any exceptions and replies, and the record in contested cases.

Third, the time needed to process audit adjustments varies from case to case. Each decision includes an Attachment A, processed by the Audit Division to reflect adjusted or updated tax, penalty, and interest amounts.

We do commit, however, to work with the resources we have to move cases through the contested case process as quickly and accurately as possible.

3. You ask us to revise Rule 1.28 so that "if the Comptroller's office is considering revising the proposal for decision, the taxpayer is made aware of such deliberations well in advance of receiving a final decision that differs from the proposal for decision."

Response: We decline to edit the rule as requested to provide notice to a taxpayer, before a decision is issued, that a proposal for decision may or will be changed. The law requires a written decision, and it must include findings of fact and conclusions of law. The law does not contemplate a letter or similar document preceding a decision to provide notice of a change to a proposed finding of fact or a proposed conclusion of law. Likewise, the law does not contemplate a complaint – or due process in response to the complaint - after a letter that forecasts a change that has not yet occurred and may or may not occur to a proposal for decision. Instead, the law requires a motion for rehearing to complain - and to receive due process in response - after a signed contested case decision or order.

Rule 1.29 (Motion for Rehearing)

1. Relating to subsection (d), motions for extensions of time, you ask that the Comptroller's office revise the rule so that motions for extensions of time are deemed granted by operation of law, unless denied by order. You noted particular concern about a circumstance in which a taxpayer timely submitted a motion for extension of time but received no response from the Comptroller's office.

Response: We decline to edit the rule for the following reasons. Tex. Gov't Code § 2001.146(e) refers to an extension by written order, not by operation of law. In fact, the law provides a specific date by which a state agency must take action, if time is extended. By statute, unless extended by written order under § 2001.146(e), the finality of a decision is prescribed by Tex. Gov't Code § 2001.144. Also, Tex. Gov't Code § 2001.146(e) provides an open date for the extended deadline, within a certain time period. The written extension order states the deadline of an action that is extended, not the statute. As a result, assuming, as the comment does, that an interpretation of the statute may exist to require (or allow) an extension by operation of law, it is unknown what the extended action date may be, if not set by written order. These facts do not indicate that the statute grants an extension of time by operation of law. Further, this is in context with another provision, subsection (f) of the same section, Tex. Gov't Code § 2001.146, that includes "by operation of law" language. In contrast, the legislature did not choose the "operation of law" standard for subsection (e).

A motion to extend time must be filed with the Comptroller, with a copy served on each party to the case. Assuming a motion for extension is filed as required, the Comptroller grants and denies extensions by written order, which means that a taxpayer receives a response from the Comptroller.

Rule 1.32 (Service of Documents on Parties)

1. In subsection (a), the draft proposal refers to Rule 1.5, initiation of a hearing, for a statement of when a contested case begins for purposes of applicability of service and notice rules for the contested case. You request a clear statement of the date a contested case begins, and suggest that Rule 1.5 needs amendment. You suggest a rule to state that a contested case begins on the date the taxpayer receives notice that the agency has initiated a hearing as opposed to the date the taxpayer requests a hearing.

Response: We will review Rule 1.5 for potential amendment in the future as part of our review of all the practice and procedure rules and will consider your comments as part of this ongoing process.

2. You also state that subsection (e)(2) is confusing as currently worded, and have suggested rule language. The request to change the rule language does not change the substance of the draft proposal.

Response: We have edited the rule in response to your comment.

Rule 1.41 (Ex Parte Communications)

1. You state that subsection (a)(4) is overbroad in comparison to Tex. Gov't Code § 2001.061(a). You state that the Comptroller and the Deputy Comptroller should remain available to taxpayers to discuss tax matters. You suggest that ex parte laws are a trap for the unwary who seek to discuss general tax issues with the Comptroller and agency personnel. You note that the statute does not include Special Counsel or his or her staff. You propose that the only person with whom ex parte communications are expressly prohibited is the administrative law judge assigned to the contested case.

Response: We decline to change the rule in response to your comments. Tex. Gov't Code § 2001.061(a) states: "(a) Unless required for the disposition of an ex parte matter authorized by law, a member or employee of a state agency assigned to render a decision or to make findings of fact and conclusions of law in a contested case may not directly or indirectly communicate in connection with an issue of fact or law with a state agency, person, party, or a representative of those entities, except on notice and opportunity for each party to participate."

This provision expressly prohibits ex parte communication with "a member or employee of a state agency assigned to render a decision," which includes indirect communication. In this agency, the employee assigned to render a decision in tax hearings is the Deputy Comptroller, and staff in the Office of Special Counsel for Tax Hearings provides legal advice to the Deputy Comptroller with respect to the proposals for decision.

We decline to edit the draft rule on the suggested basis that the draft proposal restrains a taxpayer's access to an elected official or the Deputy Comptroller. You refer to communication of tax matters that are important to taxpayers. However, § 2001.061(a) is more narrow than the comment seems to suggest. The law in § 2001.061(a) restrains access only to certain persons for certain purposes in the context of a pending contested case, when the communication is without other parties (it is ex parte) and the communication is about an issue of fact or law pending a final decision, unless notice to each party and the opportunity to participate is given. Therefore, in order to make sure our rules stay consistent with the law, we decline to revise the draft rule in response to the comments.

Thank you again for your comments. Your involvement in this rulemaking project is important, and we appreciate the work and time involved in submitting comments.

Sincerely,

Nancy L. Prosser

Nancy Prosser
Special Counsel to the Deputy Comptroller
On behalf of the Agency's Practice & Procedure Rule Drafting Group

TAX SECTION
State Bar of Texas

May 19, 2017

Via E-mail to SpecialCounsel.Filings@cpa.texas.gov

Gina Calviño
Legal Assistant, Office of Special Counsel for Tax Hearings
P.O. Box 13258
Austin, Texas 78711-3528

RE: Comments on Proposed Amendments to 34 Tex. Admin. Code § 1.8, "Resolution Agreements"

Dear Ms. Calviño:

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed response to the request of the Texas Comptroller of Public Accounts for comments pertaining to the Proposed Amendments to 34 Tex. Admin. Code § 1.8. The proposal appeared in the April 21, 2017, edition of the Texas Register.

THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE TAX SECTION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE TAX SECTION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW.

THE COMMENTS ARE SUBMITTED AS A RESULT OF THE APPROVAL OF THE COMMITTEE ON GOVERNMENT SUBMISSIONS OF THE TAX SECTION AND PURSUANT TO THE PROCEDURES ADOPTED BY THE COUNCIL OF THE TAX SECTION, WHICH IS THE GOVERNING BODY OF THAT

SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend the Texas Comptroller of Public Accounts for the time and thought that has been put into preparing the proposed amendments to 34 Tex. Admin. Code § 1.8, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

David E. Colmenero, Chair
State Bar of Texas, Tax Section

COMMENTS ON PROPOSED AMENDMENTS TO 34 TEX. ADMIN. CODE § 1.8

These comments on the Proposed Amendments to 34 Tex. Admin. Code § 1.8 ("Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafter of these Comments was Sam Megally, Chair of the State and Local Tax ("SALT") Committee of the Tax Section of the State Bar of Texas. The Committee on Government Submissions ("COGS") of the Tax Section of the State Bar of Texas has approved these Comments. Ira Lipstet, Co-Chair of COGS, also reviewed the comments and made substantive suggestions on behalf of COGS.

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 19, 2017

I. INTRODUCTION

These Comments are in response to the publication of Proposed Amendments to 34 Tex. Admin. Code § 1.8 (the "Proposed Rule"), by the Texas Comptroller of Public Accounts (the "Comptroller") in the April 21, 2017, edition of the Texas Register.

We recognize and appreciate the time and thoughtful work invested by the Comptroller's office in preparing the Proposed Rule. We also appreciate the efforts of the Comptroller to survey existing authority and update existing Rules, particularly as needed to reflect statutory changes. These efforts are extremely useful to taxpayers and practitioners. It is our intent to present items for consideration that may help and support Comptroller personnel in this endeavor.

II. COMMENTS REGARDING PROPOSED RULE

The Proposed Rule addresses circumstances in which the Comptroller's office and a taxpayer resolve a contested case by agreement, and sets forth the steps by which the parties may memorialize such an agreement. Subsection (c)(1) provides that Comptroller's office staff are to begin a draft of any such resolution agreement by using a standard form approved by the Comptroller's office. We understand that the Comptroller's office has been preparing a new draft form resolution agreement, and we note respectfully that we cannot comment on the reasonableness of the form agreement requirement in the Proposed Rule without seeing the current draft of such form agreement.

We understand from prior communications that the Comptroller's office believes utilizing a standard form will encourage consistency and prevent mistakes, though the agency also wishes to preserve its "ability to make slight changes to the standard agreement as may be appropriate." As a general matter, we respectfully suggest that the Comptroller should consider striking the explicit requirement that agency staff begin with an approved form. Our concern is that codifying the requirement for such a standard form in the Administrative Code could discourage agency staff from agreeing to reasonable and necessary changes that a taxpayer may request. Because of the importance of the Proposed Rule to the fair and efficient resolution of contested cases, we respectfully suggest that, until interested parties have had an opportunity to review and comment on the proposed standard resolution form, the Comptroller either delay adoption of the Proposed Rule or adopt the Proposed Rule without the standard form requirement.

Subsection (c)(7) of the Proposed Rule provides that, when a taxpayer and the Comptroller's office determine and agree that adjustments set forth in a resolution agreement were calculated in error, the parties may execute an amendment to the resolution agreement. To avoid confusion or uncertainty about the procedure for handling such a circumstance, we respectfully suggest that the Comptroller clarify in the Proposed Rule that agency staff is responsible for preparing an amendment that correctly effectuates the parties' intent and sending it to the taxpayer for approval and execution.

III. CONCLUSION

We greatly appreciate the opportunity to work with your office on these significant tax issues and hope these Comments provide relevant analysis for your review. We also reiterate our earlier request for a roundtable meeting to address these issues, and would welcome the opportunity to participate in such a discussion. Thank you for your consideration.

TAX SECTION
State Bar of Texas

May 19, 2017

Via E-mail to SpecialCounsel.Filings@cpa.texas.gov

Gina Calviño
Legal Assistant, Office of Special Counsel for Tax Hearings
P.O. Box 13258
Austin, Texas 78711-3528

RE: Comments on Proposed Amendments to 34 Tex. Admin. Code § 1.28, "Comptroller's Decisions and Orders"

Dear Ms. Calviño:

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed response to the request of the Texas Comptroller of Public Accounts for comments pertaining to the Proposed Amendments to 34 Tex. Admin. Code § 1.28. The proposal appeared in the April 21, 2017, edition of the Texas Register.

THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE TAX SECTION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE TAX SECTION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW.

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SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend the Texas Comptroller of Public Accounts for the time and thought that has been put into preparing the Proposed Amendments to 34 Tex. Admin. Code § 1.28, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

David E. Colmenero, Chair
State Bar of Texas, Tax Section

COMMENTS ON PROPOSED AMENDMENTS TO 34 TEX. ADMIN. CODE § 1.28

These comments on the Proposed Amendments to 34 Tex. Admin. Code § 1.28 ("Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafter of these Comments was Sam Megally, Chair of the State and Local Tax ("SALT") Committee of the Tax Section of the State Bar of Texas. The Committee on Government Submissions ("COGS") of the Tax Section of the State Bar of Texas has approved these Comments. Ira Lipstet, Co-Chair of COGS, also reviewed the comments and made substantive suggestions on behalf of COGS.

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 19, 2017

I. INTRODUCTION

These Comments are in response to the publication of Proposed Amendments to 34 Tex. Admin. Code § 1.28 (the "Proposed Rule"), by the Texas Comptroller of Public Accounts (the "Comptroller") in the April 21, 2017, edition of the Texas Register.

We recognize and appreciate the time and thoughtful work invested by the Comptroller's office in preparing the Proposed Rule. We also appreciate the efforts of the Comptroller to survey existing authority and update existing Rules, particularly as needed to reflect statutory changes. These efforts are extremely useful to taxpayers and practitioners. It is our intent to present items for consideration that may help and support Comptroller personnel in this endeavor. Text should be:

II. COMMENTS REGARDING PROPOSED RULE

Proposed Rule 1.28 relates to the issuance of Comptroller decisions and orders. Our observation has been that the time between the Comptroller's office acquiring from the State Office of Administrative Hearings jurisdiction of a contested case and the Comptroller's issuance of a final decision can sometimes be extremely long; during this time, taxpayers typically have no way to determine when a final decision might be issued. Such delays can create uncertainty as to the Comptroller's intent with respect to the proposals, cause considerable confusion as to the appropriate course of action to take during the extended period of time during which a proposal for decision is issued but not yet finalized, and ultimately increase the amount of interest for which a taxpayer is liable. We respectfully suggest that the Comptroller incorporate into the Proposed Rule a standard timeframe within which the agency is required to issue a final decision. To the extent the Comptroller's office requires additional time, we suggest further that the Comptroller's office should be entitled to an extension of such timeframe upon providing a written explanation of the reasons for the extension to the taxpayer.

We understand from prior communications that delays at this stage often relate to cases' varying complexities and the time required for Audit Division to process adjustments. Nevertheless, we respectfully suggest that fairness requires that taxpayers be kept apprised of the status of their cases, particularly in light of the long delays practitioners and taxpayers have experienced while the Comptroller is considering proposals for decision. During such time, information about a case's progress is within the sole possession of the Comptroller, and we believe our proposal provides for a mechanism by which such information may also be made available to the taxpayer.

III. CONCLUSION

We greatly appreciate the opportunity to work with your office on these significant tax issues and hope these Comments provide relevant analysis for your review. We also reiterate our earlier request for a roundtable meeting to address these issues, and would welcome the opportunity to participate in such a discussion. Thank you for your consideration.

TAX SECTION
State Bar of Texas

May 19, 2017

Via E-mail to SpecialCounsel.Filings@cpa.texas.gov

Gina Calviño
Legal Assistant, Office of Special Counsel for Tax Hearings
P.O. Box 13258
Austin, Texas 78711-3528

RE: Comments on Proposed Amendments to 34 Tex. Admin. Code § 1.29, "Motion for Rehearing"

Dear Ms. Calviño:

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed response to the request of the Texas Comptroller of Public Accounts for comments pertaining to the Proposed Amendments to 34 Tex. Admin. Code § 1.29. The proposal appeared in the April 21, 2017, edition of the Texas Register.

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SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend the Texas Comptroller of Public Accounts for the time and thought that has been put into preparing the Proposed Amendments to 34 Tex. Admin. Code § 1.29, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

David E. Colmenero, Chair
State Bar of Texas, Tax Section

COMMENTS ON PROPOSED AMENDMENTS TO 34 TEX. ADMIN. CODE § 1.29

These comments on the Proposed Amendments to 34 Tex. Admin. Code § 1.29 ("Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafter of these Comments was Sam Megally, Chair of the State and Local Tax ("SALT") Committee of the Tax Section of the State Bar of Texas. The Committee on Government Submissions ("COGS") of the Tax Section of the State Bar of Texas has approved these Comments. Ira Lipstet, Co-Chair of COGS, also reviewed the comments and made substantive suggestions on behalf of COGS.

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 19, 2017

I. INTRODUCTION

These Comments are in response to the publication of Proposed Amendments to 34 Tex. Admin. Code § 1.29 (the "Proposed Rule"), by the Texas Comptroller of Public Accounts (the "Comptroller") in the April 21, 2017, edition of the Texas Register.

We recognize and appreciate the time and thoughtful work invested by the Comptroller's office in preparing the Proposed Rule. We also appreciate the efforts of the Comptroller to survey existing authority and update existing Rules, particularly as needed to reflect statutory changes. These efforts are extremely useful to taxpayers and practitioners. It is our intent to present items for consideration that may help and support Comptroller personnel in this endeavor.

II. COMMENTS REGARDING PROPOSED RULE

Proposed Rule 1.29 sets forth the procedures and requirements for filing motions for rehearing following the issuance of a decision or order. Subsection (d), relating to motions for extension of time, provides that if the Comptroller has not by the 10th day after the initial deadline for the motion for rehearing acted on a motion for extension of time, such motion for extension of time is considered overruled. Our view is that the Comptroller should whenever possible avoid limiting taxpayers' ability to satisfy statutory and administrative requirements, particularly when those requirements have jurisdictional ramifications; the standard articulated in the Proposed Rule, by contrast, has the potential to be a trap for the unwary. Particularly in a circumstance in which a taxpayer has timely submitted a motion for extension of time and shown the need for such an extension, we respectfully suggest that it is inconsistent with sound tax policy to effectively allow the Comptroller's office to overrule such motion for extension of time without acknowledgment or response.

We understand from prior communications that the Comptroller's interpretation of Government Code § 2001.146(e) does not allow for motions for extension of time on which the Comptroller's office has failed to act to be deemed granted by operation of law rather than denied. We respectfully suggest that the Comptroller's office could consider addressing this concern by pre-issuing in each case a standard written order providing that, if no action has been taken on a motion for extension after the deadline to file a motion for rehearing, such deadline to file the motion for rehearing is extended by a certain number of days; such an approach would ensure that no motion for extension of time will be considered overruled because of inattention on the part of Comptroller staff. Even if the Comptroller's office intends to retain current subsection (d)(1) in the Proposed Rule, we propose also adding to the Proposed Rule a clear requirement that the Comptroller's office shall rule on all motions for extension of time within 10 days of the filing of such motion.

III. CONCLUSION

We greatly appreciate the opportunity to work with your office on these significant tax issues and hope these Comments provide relevant analysis for your review. We also reiterate our earlier request for a roundtable meeting to address these issues, and would welcome the opportunity to participate in such a discussion. Thank you for your consideration.

TAX SECTION
State Bar of Texas

May 19, 2017

Via E-mail to SpecialCounsel.Filings@cpa.texas.gov

Gina Calviño
Legal Assistant, Office of Special Counsel for Tax Hearings
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Austin, Texas 78711-3528

RE: Comments on Proposed New 34 Tex. Admin. Code § 1.41, "Ex Parte Communications"

Dear Ms. Calviño:

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed response to the request of the Texas Comptroller of Public Accounts for comments pertaining to Proposed New 34 Tex. Admin. Code § 1.41. The proposal appeared in the April 21, 2017, edition of the Texas Register.

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SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend the Texas Comptroller of Public Accounts for the time and thought that has been put into preparing Proposed New 34 Tex. Admin. Code § 1.41, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

David E. Colmenero, Chair
State Bar of Texas, Tax Section

COMMENTS ON PROPOSED NEW 34 TEX. ADMIN. CODE § 1.41

These comments on Proposed New 34 Tex. Admin. Code § 1.41 ("Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafter of these Comments was Sam Megally, Chair of the State and Local Tax ("SALT") Committee of the Tax Section of the State Bar of Texas. The Committee on Government Submissions ("COGS") of the Tax Section of the State Bar of Texas has approved these Comments. Ira Lipstet, Co-Chair of COGS, also reviewed the comments and made substantive suggestions on behalf of COGS.

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 19, 2017

I. INTRODUCTION

These Comments are in response to the publication of Proposed New 34 Tex. Admin. Code § 1.41 (the "Proposed Rule"), by the Texas Comptroller of Public Accounts (the "Comptroller") in the April 21, 2017, edition of the Texas Register.

We recognize and appreciate the time and thoughtful work invested by the Comptroller's office in preparing the Proposed Rule. We also appreciate the efforts of the Comptroller to survey existing authority and update existing Rules, particularly as needed to reflect statutory changes. These efforts are extremely useful to taxpayers and practitioners. It is our intent to present items for consideration that may help and support Comptroller personnel in this endeavor.

II. COMMENTS REGARDING PROPOSED RULE

The Proposed Rule sets forth the limitations on communications between parties to a contested case and persons assigned to render decisions or make findings of fact and conclusions of law. Subsection (a)(4) sets forth a list of persons who "participate in rendering decisions," and with whom ex parte communications are prohibited, including the Comptroller, and staff of the Office of Special Counsel for Tax Hearings. We respectfully suggest that this provision is inconsistent with and overbroad as compared to Government Code § 2001.061(a), which prohibits ex parte communications only with persons who are "assigned to render a decision or to make findings of fact and conclusions of law," and not all persons who participate in rendering decisions or making findings and conclusions.

We understand from prior communications that "the [Comptroller's office] employee assigned to render a decision in tax hearings is the Deputy Comptroller, and staff in the Office of Special Counsel for Tax Hearings provides legal advice to the Deputy Comptroller with respect to the proposals for decision." It is our view that the Comptroller, who is an elected official, must remain at all times available to taxpayers, including as required by the U.S. and Texas Constitutions; The agency's explanation of the Comptroller personnel responsible for rendering decisions demonstrates that ensuring taxpayer access to the Comptroller, even during the pendency of a contested case, is workable and should remain at all times permissible.

Indeed, we suggest that the Comptroller's office should err at all times in favor of granting taxpayers unfettered access to Comptroller personnel and protecting taxpayers' ability to discuss with Comptroller personnel a wide range of tax matters. To the extent the Comptroller elects to delegate tasks to his Deputy Comptroller, we observe that it is likely that taxpayers would seek reasonable access to the Deputy Comptroller in connection with meetings to discuss tax matters of importance to taxpayers. In addition, while taxpayers may be able to determine who the Comptroller's Special Counsel for Tax Hearings is, they are unlikely to be able to determine which Comptroller personnel are on the Special Counsel's staff. We respectfully note that broadening the ex parte prohibition to include not just the Special Counsel but also his or her staff goes far beyond the language and intent of Government Code § 2001.061(a).

Therefore, we propose that the Comptroller revise subsection (a)(4) so that the only person with whom ex parte communications are expressly prohibited is the administrative law judge assigned to the contested case. Alternatively, even if you decline to remove from the list the Deputy Comptroller and the Special Counsel, we propose that you remove from the list at least the Comptroller and the staff of the Office of Special Counsel.

III. CONCLUSION

We greatly appreciate the opportunity to work with your office on these significant tax issues and hope these Comments provide relevant analysis for your review. We also reiterate our earlier request for a roundtable meeting to address these issues, and would welcome the opportunity to participate in such a discussion. Thank you for your consideration.

TAX SECTION
State Bar of Texas

June 2, 2017

Via E-mail to Teresa.Bostick@cpa.texas.gov

Teresa G. Bostick
Director, Tax Policy Division
P.O. Box 13528
Austin, Texas 78711-3528

RE: Comments on Proposed Amendments to 34 Tex. Admin. Code § 3.585, "Margin: Annual Report Extension"

Dear Ms. Bostick:

On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the enclosed comments pertaining to the Proposed Amendments to 34 Tex. Admin. Code § 3.585. The proposal appeared in the May 5, 2017, edition of the Texas Register.

THE COMMENTS ENCLOSED WITH THIS LETTER ARE BEING PRESENTED ONLY ON BEHALF OF THE TAX SECTION OF THE STATE BAR OF TEXAS. THE COMMENTS SHOULD NOT BE CONSTRUED AS REPRESENTING THE POSITION OF THE BOARD OF DIRECTORS, THE EXECUTIVE COMMITTEE OR THE GENERAL MEMBERSHIP OF THE STATE BAR OF TEXAS. THE TAX SECTION, WHICH HAS SUBMITTED THESE COMMENTS, IS A VOLUNTARY SECTION OF MEMBERS COMPOSED OF LAWYERS PRACTICING IN A SPECIFIED AREA OF LAW.

THE COMMENTS ARE SUBMITTED AS A RESULT OF THE APPROVAL OF THE COMMITTEE ON GOVERNMENT SUBMISSIONS OF THE TAX SECTION AND PURSUANT TO THE PROCEDURES ADOPTED BY THE COUNCIL OF THE TAX SECTION, WHICH IS THE GOVERNING BODY OF THAT

SECTION. NO APPROVAL OR DISAPPROVAL OF THE GENERAL MEMBERSHIP OF THIS SECTION HAS BEEN OBTAINED AND THE COMMENTS REPRESENT THE VIEWS OF THE MEMBERS OF THE TAX SECTION WHO PREPARED THEM.

We commend the Texas Comptroller of Public Accounts for the time and thought that has been put into preparing the Proposed Amendments to 34 Tex. Admin. Code § 3.585, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

David Colmenero, Chair
State Bar of Texas, Tax Section

COMMENTS ON PROPOSED AMENDMENTS TO 34 TEX. ADMIN. CODE § 3.585

These comments on the Proposed Amendments to 34 Tex. Admin. Code § 3.585 ("Comments") are submitted on behalf of the Tax Section of the State Bar of Texas. The principal drafters of these Comments were Sam Megally, Chair of the State and Local Tax ("SALT") Committee of the Tax Section of the State Bar of Texas, and Sandi Farquharson, a member of the SALT Committee. The Committee on Government Submissions ("COGS") of the Tax Section of the State Bar of Texas has approved these Comments. Ira Lipstet, Co-Chair of COGS, also reviewed the comments and made substantive suggestions on behalf of COGS.

Although members of the Tax Section who participated in preparing these Comments have clients who would be affected by the principles addressed by these Comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact Person:

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Sam.Megally@KLGates.com

Date: June 2, 2017

I. INTRODUCTION

These Comments are in response to the publication of Proposed Amendments to 34 Tex. Admin. Code § 3.585 (the "Proposed Rule"), by the Texas Comptroller of Public Accounts (the "Comptroller") in the May 5, 2017, edition of the Texas Register.

We recognize and appreciate the time and thoughtful work invested by the Comptroller's office in preparing the Proposed Rule. We also appreciate the efforts of the Comptroller to survey existing authority and update existing Rules, particularly as needed to reflect statutory changes. These efforts are extremely useful to taxpayers and practitioners. It is our intent to present items for consideration that may help and support Comptroller personnel in this endeavor.

II. COMMENTS REGARDING PROPOSED RULE

The Proposed Rule removes references to the date on which taxes are due when the due date for a taxpayer's franchise tax report has been extended. *See* Proposed Rule §§ 3.585(e)(1), 3.585(e)(2), 3.585(h)(1), and 3.585(h)(2) (deleting from the current version of 34 Tex. Admin. Code § 3.585 the language "...will be the due date for any additional tax due").

Tax Code section 111.204 provides that the beginning of the statute of limitations period is the day after the last day on which a payment is required by the Tax Code chapter imposing the tax. Comptroller authority indicates that tax is due on -- and the statute of limitations period begins to run on the day following -- the extended due date for franchise tax reports. (*See, e.g.*, revisions to the Proposal for Decision in Comptroller's Hearing No. 111,470, providing that a mandatory EFT filer that requested an extension and satisfied the relevant remitting requirements "properly secured an extension of its report <u>and tax</u> due date...")

We understand that the Comptroller's office does not intend the Proposed Rule to make a substantive change to the calculation of the limitations period. However, we are concerned that deleting references to the date on which tax is due when the report due date has been extended could create confusion about when the statute of limitations period begins to run with respect to assessments and refund claims. We respectfully suggest that the Comptroller insert in the Proposed Rule a new subsection providing that, for purposes of Tax Code section 111.204, "the last day on which a payment is required" by Chapter 171 is the date to which a taxpayer has been granted an extension of the due date for a report.

III. CONCLUSION

We greatly appreciate the opportunity to work with your office on these significant tax issues and hope these Comments provide relevant analysis for your review. We also reiterate our earlier request for a roundtable meeting to address these issues, and would welcome the opportunity to participate in such a discussion. Thank you for your consideration.

TAX SECTION
OF
THE STATE BAR OF TEXAS

2016 – 2017 CALENDAR

June 2016	
6	**Pro Bono Calendar Call-Houston**
8	**2016-2017 Tax Section Officer Planning Retreat** Meadows Collier 901 Main Street, Suite 3700, Dallas, TX 75202 11:30 a.m. – 3:30 p.m.
8 – 10	**Annual Texas Federal Tax Institute** Hyatt Hill Country Resort San Antonio, TX
15	**Leadership Academy Reception & Dinner @ Reata Restaurant** 310 Houston Street Fort Worth, TX 76102 6:30 p.m. Reception & 7:00 p.m. Dinner
15 - 17	**Leadership Academy Program (2nd of 4 programs)** Fort Worth Omni and Convention Center 1300 Houston St. Fort Worth, TX 76102
16	**2016-2017 Tax Section Council Planning Retreat** Location: City Club, Speaker's Room – 4th Flr. 301 Commerce St. Fort Worth, TX 76102 1:00 p.m. - 4:00 p.m.
16	**2016 Tax Section Annual Meeting Speaker's Dinner** Reata Restaurant 310 Houston St. Fort Worth, TX 76102 Cocktails @ 6:30 p.m. – Roof Top Terrace Dinner @7:30 p.m.- the Dome
16	**Presentation of Law Student Scholarship Awards** Award Presentations at State Bar Annual Meeting, Speakers' Dinner Reata Restaurant 310 Houston St. Fort Worth, TX 76102 Cocktails @ 6:30 p.m. – Roof Top Terrace Dinner @7:30 p.m.

17	**2016 Tax Section Annual Meeting Program** Fort Worth Omni and Convention Center 1300 Houston St. Fort Worth, TX 76102
17	**Presentation of 2016 Outstanding Texas Tax Lawyer Award** Award Presentation During Tax Section Annual Meeting Program
21	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 866-203-7023; Conference Code: 7136515591# Jeff Blair hosting 9:00am
28	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
July 2016	
14-16	**Texas Bar College** Summer School Moody Gardens Hotel Galveston, TX
19	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
25	**SBOT Chair and Treasurer Training** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
26	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
August 2016	
4 – 9	**ABA Annual Meeting** **Taxation Section – Aug. 5th @ Four Seasons** San Francisco, CA
16	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
23	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
26	**Meeting of Council, Committee Chairs, and Committee Vice Chairs (up to 30-40 pp)** Hosted by Jones Day Dallas, TX 10:30 a.m. – 12:30 a.m. w/lunch Dial-in information will be distributed via email.
27	**Tax Resolution Day (for Taxpayers scheduled for the 9/26 and 10/17 trial sessions** **9:00 a.m. – 12 Noon (extend timeframe if needed)**
Sept 2016	
12	**Pro Bono Calendar Call** **Small Tax Case Calendar** **United States Tax Court** Houston

15	**Deadline for Appointment of Tax Section Nominating Committee** Chair: David Colmenero
16	**Submission Deadline – Texas Tax Lawyer (Fall Edition)** Submit to TTL Editor: Michelle Spiegel mspiegel@mayerbrown.com
20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
22	**Leadership Academy Tour – Menil Collection &** **Dinner-Link Lee Mansion – Univ. of St. Thomas** **Houston, TX** 5:00 p.m.
23	**Leadership Academy (3rd of 4 programs)** Law Offices of Norton Rose Fulbright Houston, TX 8:15 a.m.
26	**Pro Bono Calendar Call** **Small Tax Case Calendar** **United States Tax Court** Dallas
27	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
29	**ABA Joint Fall CLE Meeting** Westin Boston Waterfront Boston, MA
Oct 2016	
4	**State and Local Tax Committee Annual Comptroller Briefing** **Co-Sponsored with TSCPA and TEI** Austin, TX
7	**Council of Chairs Meeting** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
15	**Tax Resolution Day (for Taxpayers scheduled for the 11/14 and 11/28 trial sessions** **9:00 a.m. – 12 Noon (extend timeframe if needed)**
17	**Pro Bono Calendar Call** **Regular Case Calendar** **United States Tax Court** Dallas
18	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
19	**Outreach to Law Schools** Southern Methodist University Dedman School of Law Dallas, TX
25	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**

25-26	**Advanced Tax Law Course** **Co-Sponsored with TexasBarCLE** Location: TBD Austin, TX Note: Information re: program, registration and hotel will be available 2 mths. prior to program date.
28-29	**National Association of State Bar Tax Sections ("NASBTS") Annual Meeting** **San Francisco, CA**
31*	**Pro Bono Calendar Call** **Regular and Small Tax Case Calendar** **United States Tax Court** El Paso ***Note: *10/31 (3) - Starting Date (Duration)***
Nov 2016	
3	**Pro Bono Calendar Call** **Regular & Small Tax Case Calendar** **United States Tax Court** Lubbock ***Note: *11/03 (2) - Starting Date (Duration)***
3	**19th Annual International Tax Symposium** **Co-Sponsored with the Dallas CPA Society** Cityplace Conference Center Dallas, TX
3	**Outreach to Law Schools** Texas Tech University School of Law Lubbock, TX
4	**19th Annual International Tax Symposium** **Co-Sponsored with the Houston CPA Society** 777 Post Oak Blvd., Suite 500 Houston, TX 77056
10	**Meeting of Council** (approx. 20-24pp) Meadows Collier 901 Main Street, Suite 3700, Dallas, TX 75202 Dallas, TX 10:30 a.m. – 12:30 a.m. w/lunch
14	**Pro Bono Calendar Call** **Small Tax Case Calendar** **United States Tax Court** Dallas
15	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
22	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**

28	**Pro Bono Calendar Call** **Regular Case Calendar** **United States Tax Court** Dallas
Dec. 2016	
5	**Pro Bono Calendar Call** **Regular Case Calendar** **United States Tax Court** Houston
13	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
27	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
Jan. 2017	
6	**Nomination Period Opens for 2017 Outstanding Texas Tax Lawyer Award** • Nominations due April 1, 2017 • Nomination forms to be posted on website and distributed via eblast • Submit nomination forms to Tax Section Secretary: Catherine Scheid (ccs@scheidlaw.com)
9	**Pro Bono Calendar Call** **Small Tax Case Calendar** **United States Tax Court** San Antonio
13	**Submission Deadline – Texas Tax Lawyer (Winter Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel88@gmail.com
16	**Application Period Opens for Law Student Scholarship Program**
17	**Leadership Academy Happy Hour w/Austin Chapter CPA Leap Group** **Charles Johnson House** **Austin, TX** 6:00 p.m.– 9:00 p.m.
18	**Leadership Academy (4th of 4 programs)** **Norton Rose Fulbright** **Austin, TX** 8:15 a.m. – 5:00 p.m.
18	**Leadership Academy Graduation Dinner w/Emily Parker** **Max's Wine Dive** **Austin, TX** 6:00 p.m. – 8:30 p.m.
19	**Outreach to Law Schools** Texas A&M Law School Fort Worth, TX
19-21	**ABA Midyear Meeting** Hilton Bonnet Creek & Waldorf Astoria Orlanda, FL

24	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
24	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
27	**Meeting of Council, Committee Chairs, and Committee Vice Chairs (up to 30-40 pp)** Hosted by Norton Rose Fulbright Houston, TX 10:30 a.m. – 12:30 a.m. w/lunch Dial-in information will be distributed via email.
30	**Pro Bono Calendar Call** **Regular Case Calendar** **United States Tax Court** Dallas
Feb. 2017	
3	**Tax Law in a Day CLE** Location: Dallas (Cityplace Conference Center)
13	**Pro Bono Calendar Call** **Small Tax Case Calendar** **United States Tax Court** Houston
17	**Council of Chairs Meeting** Texas Law Center 1414 Colorado St. Austin, TX 78701 10:30 a.m. – 2:30 p.m.
21	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
28	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
March 2017	
1	**Nomination Deadline for Chair-Elect, Secretary, Treasurer, and 3 Elected Council Members**
6	**Pro Bono Calendar Call** **Regular Case Calendar** **United States Tax Court** Houston
	Calendar Call - Dallas
	Calendar Call – San Antonio
7	**Law School Outreach – The University of Texas at Austin School of Law** **Austin, TX**
21	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am

27	**Pro Bono Calendar Call** **Regular Case Calendar** **United States Tax Court** Houston
28	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
29	**Law School Outreach – UNT Dallas College of Law** **Dallas, TX**
April 2017	
1	**Nominations for Outstanding Texas Tax Lawyer Due to Catherine Scheid** Email**:** (ccs@scheidlaw.com)
6	**Law School Outreach - University of Houston Law Center** **Houston, TX**
7	**Law Student Scholarship Application Deadline**
11	**Nominating Committee Report Due to Council**
14	**Submission Deadline – Texas Tax Lawyer (Spring Edition)** Submit to TTL Editor: Michelle Spiegel michelle.spiegel88@gmail.com
18	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
21	**Meeting of Council (20-24 pp)** Meadows Collier 901 Main Street, Suite 3700, Dallas, TX 75202 10:30 a.m. – 12:30 a.m. w/lunch **Note: Council Vote and Selection of Recipient of 2017 Outstanding Texas Tax Lawyer Award**
24	**Pro Bono Calendar Call** **United States Tax Court** Dallas
24	**Pro Bono Calendar Call** **United States Tax Court** Houston
25	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
	Property Tax Committee Meeting and Legal Seminar Location: TBD
May 2017	
1	**Pro Bono Calendar Call** **United States Tax Court** San Antonio
11-13	**ABA May Meeting** Grand Hyatt Washington, DC
23	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am

23	**SBOT Tax Section Officer Monthly Call/Meeting @ 4:00 p.m.**
June 2017	
5	**Pro Bono Calendar Call** **United States Tax Court** Dallas
14-16	**Annual Texas Federal Tax Institute** La Cantera Resort & Spa San Antonio, TX
20	**Government Submissions (COGS) Call with Committee Chairs** Dial-in: 800-525-8970; Conference Code: 2143975538# Henry Talavera 9:00am
22-23	**SBOT Annual Meeting** Hilton Anatole Dallas, TX
22	**Tax Section Council Planning Retreat** Hilton Anatole Dallas, TX 1:00 p.m. - 4:00 p.m.
22	**2017 Tax Section Annual Meeting Awards and Speakers' Dinner** Location: Sambuca Dallas, TX
22	**Presentation of 2017 Outstanding Texas Tax Lawyer Award** Award Presentation During Tax Section Annual Meeting Awards and Speakers' Dinner Sambuca Dallas, TX
22	**Presentation of Law Student Scholarship Awards** Awards Presentation During Tax Section Annual Meeting Awards and Speakers' Dinner Location: Sambuca Dallas, TX
23	**2017 Tax Section Annual Meeting CLE Program** Hilton Anatole Dallas, TX

TAX SECTION

STATE BAR OF TEXAS

LEADERSHIP ROSTER

2016-2017

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TAX SECTION

THE STATE BAR OF TEXAS

COMMITTEE CHAIRS AND VICE CHAIRS

2016-2017

COMMITTEE	CHAIR	VICE CHAIR
1. **Annual Meeting**	**Ben Vesely** BDO USA, LLP 700 N. Pearl St., Suite 2000 Dallas, Texas 75201 214-665-0763 bvesely@bdo.com	**N/A** (Planning Committee)
2. **Continuing Legal Education**	**J. Michael Threet** Haynes & Boone, LLP 2323 Victory Ave., Suite 700 Dallas, Texas 75219 214-651-5091 michael.threet@haynesboone.com	**Amanda Traphagan** Seay Traphagan 807 Brazos St., Suite 304 Austin, Texas 78701 512-582-0120 atraphagan@seaytaxlaw.com **Jim Roberts** Glast, Phillips & Murray, PC 14801 Quorum Dr., Suite 500 Dallas, Texas 75254 972-419-7189 jvroberts@gpm-law.com
3. **Corporate Tax**	**Jeffry M. Blair** Hunton & Williams, LLP 1445 Ross Ave., Suite 3700 Dallas, Texas 75202 214-468-3306 jblair@hunton.com **Ryan Gardner** Gardner Firm PLLC 6793 Old Jacksonville, Ste. B Tyler, Texas 75703 903-705-1101 rg@glgtx.com	

COMMITTEE	CHAIR	VICE CHAIR
4. **Employee Benefits**	**Susan A. Wetzel** Haynes & Boone 2323 Victory Ave., Suite 700 Dallas, Texas 75219 214-651-5389 susan.wetzel@haynesboone.com	**(Joe) Robert Fowler** Baker Botts, LLP 910 Louisiana St. Houston, Texas 77002-4995 713-229-1229 rob.fowler@bakerbotts.com
	Henry Talavera Polsinelli PC 2501 N. Harwood, Suite 1900 Dallas, Texas 75201 214-661-5538 htalavera@polsinelli.com	**Sarah Fry** Locke Lord Edwards 2200 Ross Ave., Suite 2200 Dallas, Texas 75201 214-740-8424 sarah.fry@lockelord.com
		James R. Griffin Jackson Walker 901 Main St., Suite 600 Dallas, Texas 75202 214-953-5827 jgriffin@jw.com
5. **Energy and Natural Resources Tax**	**Crawford Moorefield** Strasburger & Price 909 Fanning St., Suite 2300 Houston, Texas 77010 713-951-5629 crawford.moorefield@strasburger.com	**Todd Lowther** Thompson & Knight, LLP 333 Clay St., Houston, Texas 77002 713-653-8667 todd.lowther@tklaw.com
		Hersh Verma Norton Rose Fulbright 1301 McKinney, Suite 5100 Houston, Texas 77010 713-651-5151 hersh.verma@nortonrosefulbright.com

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