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All articles following "411 on Fundraising for Charitable Organizations" will appear in part II

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COMMITTEE ON GOVERNMENT SUBMISSIONS:

- State Bar of Texas, Section of Taxation, Comments on Proposed Treasury Regulations Section 1.704-3, May 5, 2014
  Brandon Bloom, Thompson & Knight LLP
- State Bar of Texas, Section of Taxation, Comments on Income, Gift and Estate Tax; OMB Number: 1545-1360; Regulation Project Number: PS-102-88 (T.D. 8612), March 19, 2014
  Catherine C. Scheid, Scheid Law
  Austin Carlson, Gray Reed & McGraw P.C.
- State Bar of Texas, Section of Taxation, Response to Texas Comptroller Request for Comments Pertaining to New Rule 3.11, April 4, 2014
  Ira A. Lipstet, Dubois, Bryant & Campbell, L.L.P.
  Sam Megally, K&L Gates LLP
  Charolette Noel, Jones Day
  Alyson Outenreath, Texas Tech University School of Law

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State and Local Tax – Overview and Updates

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The State Bar of Texas
Section of Taxation - Tax Law Survey in a Day
February 28, 2014
Cityplace, Dallas

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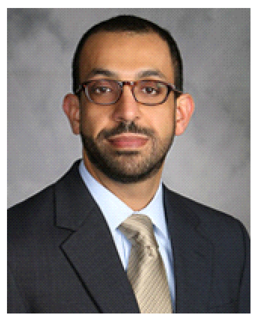

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PRIMARY PRACTICE

- Tax

SECONDARY PRACTICES

- Public Policy and Law

AREAS OF PRACTICE

Mr. Megally's practice includes state tax planning and controversy matters focusing on income tax, sales tax, franchise tax, and property tax, as well as tax-related legislative and administrative representations.

PRESENTATIONS

- Presenter, "The New Texas Margin Tax a/k/a the 'New and Improved Franchise Tax'," 2008 State Bar of Texas Annual Meeting: Business Law Section & Corporate Counsel Section CLE, June 26, 2008

PUBLICATIONS

- Texas Comptroller Announces Limited Tax Amnesty Program, Tax and Public Policy and Law Alert, March 21, 2012
- Supreme Court Denies Cert in *KFC* and *Lamtec* Cases, Tax Alert, October 11, 2011
- Texas Tax "News": New Tax Bill, New Planning Opportunities, New Amnesty Program, Corporate eAlert, a Hughes & Luce publication, May 30, 2007
- Good Deeds, Good Business, quoted in Texas Lawyer, July 31, 2006
- Taxation', SMU Law Review Annual Survey, 2006-present

PROFESSIONAL/CIVIC ACTIVITIES

- American Bar Association
  - Tax Section
- State Bar of Texas
  - Tax Section and State and Local Tax Committee
  - Vice-Chair, State and Local Tax Committee, 2011
- Texas Young Lawyer's Association
- Dallas Bar Association
  - Tax Section
- Dallas Association of Young Lawyers
  - Leadership Class, 2006
- Greater Dallas Chamber of Commerce, Young Professionals of Greater Dallas, Board, 2007-08, Programs Committee, 2006
- Texas Diversity Council North Texas Advisory Board
- Frequent *pro bono* representations
- Intern for the Honorable Priscilla Owen, Texas Supreme Court, 2003
- Intern for R. Ted Cruz, Texas Solicitor General, 2003

ADMISSIONS

- Bar of Texas
- United States District Court for the Northern District of Texas

- United States District Court for the Western District of Texas

EDUCATION

- J.D., The University of Texas School of Law, 2005, (with honors)
- B.B.A., Southern Methodist University, 1999

LANGUAGES

- Arabic

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State and Local Tax – Overview and Updates

February 28, 2014

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THE LAY OF THE LAND

Pendulum at six o’clock

Some states are beginning to recover

- Recession-era legislation is leading to slowly-increasing tax revenues
- Some states (including Texas!) are already back to talking about tax cuts and incentives

But several states are still struggling, while others look to fund further recovery (and some politicians hope to remake outmoded tax regimes in their own images)

- More companies are making sales online
- Perennial public support for increasing revenues from non-resident taxpayers
- An increasing preference for non-property taxes?

State-level taxes

Franchise / income taxes

Sales taxes

Property taxes

Gross receipts and other “specialty” taxes

TEXAS FRANCHISE TAX

The great [?] franchise tax compromise

Bullock amendment

Eww, gross receipts

Changing economy → changing tax regimes

- Oil and gas → taxable capital
- Manufacturing and e-commerce → margin

Who's taxable? (Or: Who's not?)

Combined reporting

Texas franchise tax – a non-“net income” tax?

	Total revenue
–	Either COGS or Compensation (or 30% of total revenue or $1 million)
=	Gross margin
x	Texas apportionment factor
=	Taxable margin
	lucky retailers and wholesalers!
x	1% / 0.975% / 0.95% (or 0.5% / 0.4875% / 0.475%)
=	Tax payable (less small-business discounts)

Total revenue

Start with federal income tax returns

- Must comply with federal income tax law

Exclusions

Small-business no-tax-due and discount thresholds

The power to choose

May change election annually

- But do service businesses really have a choice?
  - Spoiler alert: more do now than did a year ago

Single election for entire combined group

Just COGS in a machine

Must own goods

Must sell goods in ordinary course

Applies only to tangible personal property (including certain mass-distributed media and software)

Includes direct costs (including labor) plus up to 4% of certain indirect or administrative costs

Excludes rental, sales, distribution, and other costs

Unfair compensation?

Wages and cash compensation up to $300,000

Benefits

- *Winstead*

No amounts paid to undocumented workers

Newpark Resources disposal services

American Multi-Cinema movie rights

Oh, to be a retailer (or a wholesaler)

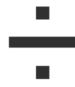
"Primarily engaged" in retail or wholesale trade

- More total revenue from retail or wholesale than from other activities
- Less than half of retail and wholesale total revenue from sales of seller-produced products
- [Almost] no utilities
- Now includes auto repair shops and certain rental businesses

Just apportion

Single-factor calculation

- Gross receipts from business done in Texas



- Gross receipts from entire business

Combined groups include gross receipts only from entities with Texas nexus

Combined reporting

Affiliated group

- One or more entities
- Controlling interest
- Owned by common owner(s)

Engaged in a unitary business (instantly?)

- Single economic enterprise
- Separate parts of a single entity or commonly controlled group of entities
- Interdependent, integrated, and interrelated
- Synergy and mutual benefit
- Sharing or exchange of value

Newpark Resources and the entity-level COGS determination (or: What?)

A target on your back

Allcat

- Allcat, a partnership, challenged constitutionality of franchise tax to the extent it taxes natural-person partners' income
- Is franchise tax a net income tax as to natural persons who own partnerships subject to tax?
- Texas Supreme Court: No, because tax is imposed on business entities

Nestle

- Nestle challenged the classifications used in the franchise tax (e.g., retailer/wholesaler, employee/contractor)
- Does franchise tax violate Texas Constitution equal and uniform requirements?
- Texas Supreme Court: No, because classifications are reasonably related to privilege of doing business

The [HB] 500 Club

Lower rates

- 2014: 0.975% (retailers / wholesalers at 0.4875%)
- 2015*: 0.95% (retailers / wholesalers at 0.475%)

*If the Comptroller says it's okay

The freedom to choose

- $1 million deduction, or 30% of revenue, or COGS, or compensation

More to love (HB 500 cont.)

Certain new activities qualify for “retail trade”

- Automotive repair shop activities
- Rental or leasing activities, including tools, party and event supplies

Deduction for relocation costs

Wait – there's more (HB 500 cont.)

New total revenue exclusions for certain taxpayers, including pharmacy network providers, aggregate transporters, landman service providers, and motor carriers

New *de minimis* standard for retail or wholesale electric utilities providers to qualify as retailers/wholesalers

Apportionment to Texas of Internet hosting receipts if customer is located in Texas

TEXAS SALES TAX

Wind in your sales

Sales tax

- Sale – in Texas
- Taxable item
  - Tangible personal property
    - "[C]an be seen, weighed, measured, felt, or touched or that is perceptible to the senses in any other manner"
    - "[I]ncludes a computer program and a telephone prepaid calling card"
  - Certain, specific taxable services

Use tax

- Storage, use, or other consumption – in Texas
- Taxable item
- Purchased from a retailer for storage, use, or other consumption in this state

Who collects?

Sales tax – typically obvious

Use tax – “retailer engaged in business in this state”

- Nexus
- Self-reporting

Exemptions (but no diverging!)

Resale

Occasional sale

Manufacturing property

Governmental entities

Certain gas/electricity

Aircraft

Wind in your resales, too!

Roark Amusement & Vending

- Were plush toys "resold" to claw machine players?

DTWC

- Does a hotel "resell" consumables?

Most disfavored nations

FM Express Food Market

- Convenience stores, gas stations, and receipt tapes
- Comptroller estimated audit procedure and the importance of contemporaneous records

Energy Education of Montana

- "Aircraft" is a dirty word
- Use of aircraft in another state before use in Texas

Come to me...

- HB 1223: Creates an exemption from state (not local) sales tax for certain data center purchases
    - Must be at least 100,000 square feet
    - Must create 20 full-time, permanent jobs
    - Must invest $200 million over following 5 years

Choose wisely…

HB 800: Tax break for R&D costs

- Sales tax exemption for TPP meeting IRC's definition of "qualified research"

OR

- Franchise tax credit of 5% of difference between qualified research expenses in report year and 50% of average QRE in last 3 years

The $50 million giveaway

HB 1133

- Provides refund for cable, Internet, and telecom (but not data processing or information) service providers of sales tax on certain TPP directly used to provide services

- Aggregate refund amount capped at $50 million, to be prorated among applicants if requests exceed that amount

TEXAS PROPERTY TAX

Herding cats

Local taxing jurisdictions (more than 3,900 of them) assess taxes on real and certain personal property

Texas Constitution: tax must be equal and uniform

Property owners responsible for submitting renditions and exemption applications (and paying... and protesting...)

The whens and whats

January 1:	Appraisal date and tax lien
February 1:	Delinquency date
April – May:	Notices of appraised value
April 15:	Renditions due
May 1:	ARB protests begin
October 1:	Tax bills

NIMBY

Key exemptions and special appraisals:

- Charitable, religious, and educational organizations
- Public, agricultural, and open space
- Goods in transit or held for export

A shorter leash

HB 585

- New training requirements for chief appraisers
- Comptroller can replace ineligible chiefs
- New presumption that refund claim is denied if tax collector takes no action in 90 days
- Districts must establish by clear and convincing evidence that a higher value is justified for property whose value was lowered the previous year

And for good measure...

HB 316

- SOAH for all!

HB 2131 and HJR 133

- Extension to freeport exemption from 175 to 730 days for certain aircraft parts (remember voting for this one?)

HB 2500

- Appraisal District must use cost method to value certain solar equipment

WHAT NEXT?

New economy, old tax codes

Technology is changing faster than legislation...

- Cloud computing
- Overseas servers
- More online sales
- Software as a service

...and all fingers point to non-residents

The Great Grabsby

Tax receipts (primarily income) on the rise, but state legislatures still looking to increase numbers and categories of taxpayers and to broaden the tax base

- Click-through and expanded nexus
  - Remote sales
- More transactions taxable
  - Digital transactions

Nexus perplexes

Quill is still the law of the land...right?

- Taxpayer physical presence in taxing state
- Online sales = modern-day catalog sales?

Due process

Interstate commerce

What's federalism got to do with it?

Transaction must have connection to taxing state too

- Substantial nexus
- Fairly apportioned
- Nondiscriminatory against interstate commerce
- Fairly related to state services

Schmommerce Clause

Legislation targeting out-of-state companies

- More remote activities → nexus for more taxpayers?
- Economic nexus

Click, click, boom

Click-through nexus provisions

- Constitutionality
  - *Amazon / Overstock*
  - *Performance Marketing*
- Affiliate activities
- No-fly zones

In-n-Out

You put your affiliates in (if we’re talking nexus determination)...

You put your affiliates out (if we’re talking taxable transactions)...

What've the Feds got to do with it?

Marketplace (Un?)Fairness Act

- Equal protection?

Internet Tax Freedom Act

- Internet access tax

In the crosshairs

Expanding sales and use taxes to cover services

- No more pretending services are actually goods
- Online services next?
- What is software? (Ask a dumb question...)

Cutting back exemptions

New specialty taxes

Flip this house (of representatives)

Property taxes – who should fund the recovery?

- Rate splits
- But businesses are people too!

They take the fun out of everything

Shame taxes

- Gambling
- Cigarettes
- Alcohol
- Gasoline
  - Mileage too?
- “Adult” activities

Dance with the one that brung ya

Income taxes primarily fueling recovery, but repeals and limitations on the table

- Increased sales and use – or property, or sin, or... – tax revenues to make up the difference
- Fewer residents on the hook

Small business exemptions / exclusions / discounts

There's gotta be a better way!

VAT

Gross receipts

~~Punishing~~ Taxing CONSUMPTION

WE’RE ALL IN THIS TOGETHER

Which of these things is not like the others?

A move toward commonality among some states (never mind the huge differences)...

- Streamlined sales tax project (juice boxes)
- MTC

...but just because DC says so?

Strange bedfellows

If all the other states jump off the [fiscal] cliff...

- *Gillette* and MTC uniformity
- Will states attempt to un-streamline next?
  - SSTP to follow in MTC's footsteps?
  - Marketplace Fairness eligibility

Sweat the small stuff

Increasing use of local option sales taxes

- Increasing rates, too

Is *intra*-state commonality too much to ask for?

Local audits: the new wild west

Outliers

No hope for commonality among unique taxes?

- Texas franchise tax
- New Mexico gross receipts tax
- Washington B&O tax

Tax indemnity planning

CAN'T WE ALL GET ALONG (ANY MORE)?

Why we can't have nice things

States' resources are spread thinly

- No legislature spends revenue windfalls on new auditors and administrative hearings attorneys
- Smaller policy and audit staffs
  - No more rulings? And no more *relying* on rulings?
  - Is that *really* a clarification?
- Increasingly aggressive audits and collections
- Contingent fee audits... and litigation

Play nice!

Increasingly impatient audit divisions

- Estimated assessments
- Fewer extensions
  - And when should taxpayers agree to extensions?

No room for error

Procedural flaws more fatal now than ever

- Who protests
- Timeliness
- Form of protest
- Protest payment
- SOL (both meanings)

The gang's all here

Employment taxes: the new presumption against independent contractors

Multijurisdictional employees

The pile-on: IRS and DOL

Stacked against you

More states moving toward independent tax appeal forums

- “Independent”?
- A real headline grabber: “TAXPAYER WINS!”

Watch your back

M&A due diligence

- Successor liability

Tax clauses

- Service contracts

Where do we go from here?

This presentation is not intended to offer legal advice. This presentation is not intended or written to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on such taxpayer under United States federal tax laws. This presentation does not constitute a tax opinion or other advice to which Circular 230 is relevant in any way, shape, or form.

Special thanks to Cindy Ohlenforst, my colleague in the Dallas office of K&L Gates LLP, with whom I have previously made presentations on which portions of this slide show are based.

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The IRS: A Former Insider's View of How it is Organized and How it Works

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Related services

- Tax
- Tax examinations and disputes

Key industry sectors

- Energy
- Transport

- Attorney, Internal Revenue Service Office of Chief Counsel, Houston District Counsel Office, Houston, Texas, 1987 - 1997
- Special Trial Attorney, Internal Revenue Service Office of Chief Counsel, Midstates Regional Counsel Office, Dallas, Texas, 1997 - 1999
- Counsel/Senior Counsel, Norton Rose Fulbright (Fulbright & Jaworski LLP), Houston, Texas, 1999 - present

Richard spent the first twelve years of his career with the Internal Revenue Service Office of Chief Counsel – ten as an Attorney in the Houston District Counsel Office and two as a Special Trial Attorney in the Midstates Regional Counsel Office. He entered private practice in 1999, joining the firm's Houston office, and has been in private practice for 13 years.

Throughout his career, Richard has focused his practice on federal tax controversies. Due to the combination of his government and private practice experience, he has developed a unique understanding of both sides of tax controversies and an extensive knowledge of federal tax procedure.

Richard has handled a wide variety of federal tax cases, including matters pertaining to income tax, estate and gift tax, employment taxes, and excise taxes, involving corporations, partnerships, individuals, and exempt organizations. He has handled examination cases at various stages of the process, from the inception of an examination, through information document requests, summonses, settlement initiatives, administrative appeals, and litigation. He has handled hundreds of cases in United States Tax Court, taking a number of cases to trial, and has handled cases in the U.S. Court of Federal Claims and federal district court. He has also handled criminal investigations and collection matters, and has advised clients with potential federal tax compliance issues prior to the development of any controversies.

THE IRS: A FORMER INSIDER'S VIEW OF HOW IT IS ORGANIZED AND HOW IT WORKS

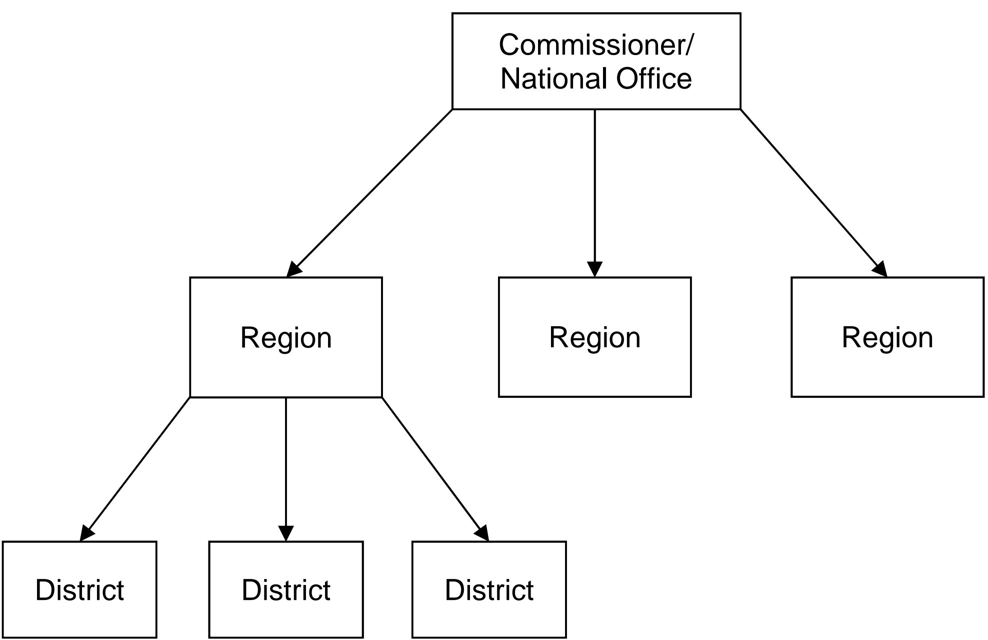
Richard L. Hunn
February 28, 2014

This presentation contains general information only and the respective speakers and their firms are not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. The respective speakers and their firms shall not be responsible for any loss sustained by any person who relies on this presentation.

Organization

A. **Historical Organization:**

1. IRS was historically organized on a 3-tier, geographic structure:



See attached organization map.

2. Historically organized on a functional basis within National Office, Regions and Districts (National Office has additional functions):

Examination Division ("Exam")	Collection Division ("Collection")	Criminal Investigation Division ("CID")

3. **IRS Chief Counsel**: Followed the same geographic model, but Counsel attorneys provided advice and services across the three major functions.

4. **IRS Appeals**: The IRS Office of Appeals has at times been part of IRS Chief Counsel and at other times has been part of the Commissioner's organization. Appeals also was historically organized on a geographic model. Typically, Appeals' mission was focused on resolving non-docketed examinations and cases docketed in United States Tax Court.

5. **Service Centers**: Historically, there was a Service Center for each Region. Within the Service Center, in addition to tax return processing functions (the "pipeline"), there was an Examination, Collection and Criminal Investigation function.

6. **Disclosure**: Historically, there was a Disclosure Office in the IRS National Office, and a District Disclosure Officer for each district.

7. **Taxpayer Ombudsman/Problem Resolution**: A national Taxpayer Ombudsman had the authority to issue a Taxpayer Assistance Order if a taxpayer was suffering or about to suffer a significant hardship (which was not defined by statute). The Taxpayer Ombudsman was not independent of the Commissioner and did not have line authority over Problem Resolution Officers in the region and district offices. Local Problem Resolution Officers did not have authority to issue Taxpayer Assistance Orders.

B. **IRS Restructuring and Reform Act of 1998**

1. **Section 1001:**

"The Commissioner of Internal Revenue shall develop and implement a plan to reorganize the Internal Revenue Service. The plan shall . . .

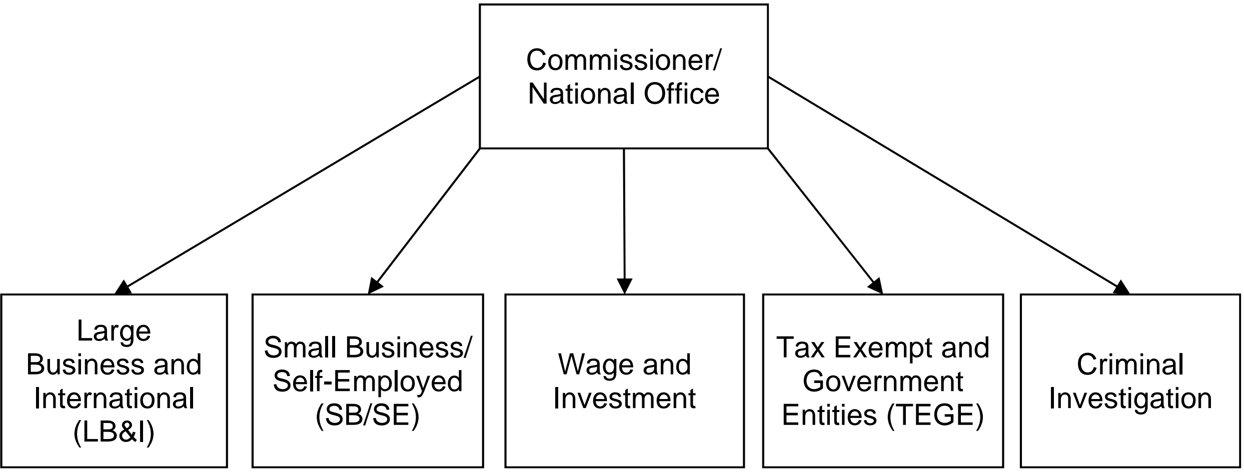
. . . eliminate or substantially modify the existing organization of the Internal Revenue Service which is based on a national, regional, and district structure;

. . . establish organizational units serving particular groups of taxpayers with similar needs:

. . . ensure an independent appeals function . . ."

2. **Section 1102 (and Code Sections 7803 and 7811)**: Established a National Taxpayer Advocate, with direct line authority over Local Taxpayer Advocates. The National Taxpayer Advocate can issue a Taxpayer Assistance Order. Provided expanded definition of significant hardship (justifying a Taxpayer Assistance Order) to include an immediate threat of an adverse action; a delay of more than 30 days in resolving a problem; incurring of significant costs if relief is not granted; and irreparable injury, or long-term adverse impact, if relief is not granted.

C. **Current Organization:** Commissioner/National Office & Divisions:



See attached organization chart for more detail.

1. **IRS Chief Counsel**: Generally reorganized along the same functional lines as the Commissioner. Chief Counsel attorneys are no longer multi-functional. Attorneys are assigned to (a) LB&I; (b) SB/SE/Wage and Investment; or (c) Criminal Investigation. LB&I is essentially large-case and examination-function oriented. Collection-related matters are handled by Counsel attorneys in SB/SE/Wage and Investment, as are tax litigation cases involving wage earners, self-employed individuals and small businesses.

2. **IRS Appeals**: The Restructuring and Reform Act added appeal rights for taxpayers with respect to collection-related matters. Taxpayers may now file a Request for a Collection Due Process Hearing in response to (a) an IRS notice of filing of a notice of federal tax lien, or (b) an IRS notice of final intent to levy. Taxpayers have the right to appeal an Appeals Officer's determination to the U.S. Tax Court. Additionally, if a taxpayer misses the opportunity for a formal Collection Due Process Appeal, he or she may request Appeals consideration of collection actions via a request for an Equivalent Hearing, or, for certain collection matters, under the Collection Appeals Program ("CAP"). In those two instances, there is no right of appeal to a court. Appeals also retains its authority to consider appeals of non-docketed examinations and docketed Tax Court cases.

3. **Functions**: Criminal Investigation continues as a separate function. While Examination and Collection were theoretically to merge, that has not occurred in practice. Collection continues to function separately within separate groups within SB/SE.

4. **Service Centers**: Service Centers are now generally part of the Wage and Investment Division, except for some compliance functions that are within SB/SE. Processing of returns is no longer divided on a strictly territorial basis, but some Service Centers process returns based on the type of taxpayer. The IRS in the last few years has started calling the Service Centers "Campuses."

5. **Disclosure**: There is still a Disclosure Office in the IRS National Office, and there are still Disclosure Officers in each of the former districts. However, FOIA requests generally are now filed in one of several centralized locations (pursuant to IRS instructions in regulations and instructions), and then sent out to a Disclosure Officer, generally in or near the city where most or all of the records in question are located, for handling.

6. **Taxpayer Advocate**: National Taxpayer Advocate can issue Taxpayer Assistance Orders and has direct line authority over Local Taxpayer Advocates. A Taxpayer Assistance Order can require the relevant IRS function to release a levy, to refrain from taking actions, to take actions, or to require that review or reconsideration be taken at a higher level within the IRS. The Taxpayer Advocate cannot use the Taxpayer Assistance Order to make substantive determinations in place of the IRS, but it can make recommendations.

The Cast of Characters

A. **Examination:**

1. **The Office Auditor**: Low-grade Exam employee; handles office audits. May not have completed a college degree.

2. **The Revenue Agent**: Higher-grade Exam employee with accounting degree; conducts field audits. Examinations in larger corporate cases are often on-site at the corporation's offices; examinations for the largest corporations are continuous, in two- or three-year audit cycles (historically known as the Coordinated Examination Program, now known as the Coordinated Industry Case program).

3. **The International Examiner**: The "IE" is a revenue agent with training and experience in international issues; IE's are assigned to IE groups, but often work on examination teams in conjunction with revenue agents, and sometime also engineers and economists.

4. **The Engineer**: IRS engineers are assigned to engineer groups, and then obtain work assignments to assist revenue agents or Chief Counsel attorneys on engineering/valuation issues in their cases. Typically IRS engineers are lateral

hires from industry, often the petroleum industry. Most have petroleum engineering degrees, but some have mechanical or other engineering degrees.

5. **The Economist**: Exam employee with economics degree. Typically are assigned to economist groups and then obtain work assignments to assist revenue agents or Chief Counsel attorneys on cases.

6. **The Attorney Examiner**: This is an attorney who conducts estate and gift tax examinations. They are not in Chief Counsel, but instead are in the SB/SE Division.

7. All of the above can issue Information Document Requests to obtain information; summonses are typically issued by revenue agents and IEs.

B. **Collection: The Revenue Officer:** Assigned to revenue officer groups and handle collection of outstanding assessed, unpaid accounts; can issue summonses to obtain financial and other information in aid of collection. Typically has a college degree, but not necessarily an accounting degree.

C. **Criminal Investigation: The Special Agent:** Assigned to special agent groups within the Criminal Investigation Division. Investigates tax crimes under Title 26, as well as related criminal violations under Title 18 for such things as conspiracy (18 U.S.C. § 371), money laundering (18 U.S.C. §§ 1956, 1957), false claims (18 U.S.C. §§ 286, 287), and false statements (18 U.S.C. § 1001); includes authority to seize property involved in money laundering and effectuate civil forfeiture. Minimum number of college hours, including accounting hours, required. Undergoes rigorous, extensive training, including in firearms. Can investigate cases administratively; can issue summonses if no referral to Department of Justice for criminal prosecution has occurred; can prepare and execute search warrants for evidence of criminal violations. Can also initiate or participate in grand jury investigations.

D. **The Chief Counsel Attorneys:**

1. **The Attorney** (General Attorney or Docket Attorney): These are Grade 11 to 14 attorneys in IRS field offices who are now assigned to either LB&I, SB/SE or Criminal Divisions. Attorneys in LB&I and SB/SE typically provide advice to Exam on their examinations, but much more so in LB&I. Counsel review is normally required on proposed notices of deficiency in larger cases or cases involving the civil fraud penalty. Counsel attorneys only litigate cases in the U.S. Tax Court. Refund litigation is handled by Department of Justice attorneys, but typically at the outset of the case, a Counsel attorney is assigned and writes a defense letter to DOJ outlining Counsel's views, and Counsel review and input is normally required on any proposed settlements.

2. **The Special Trial Attorney**: These senior, Grade 15 attorneys are assigned to LB&I and are assigned to litigate large cases, typically involving $10 million or more. The "STA" typically supervises a team of docket attorneys, revenue agents, and other IRS personnel (engineers, economists, etc.) who are assigned to assist him or her on a particular case.

3. **The Senior Counsel**: These Counsel attorneys are the same grade-level as Special Trial Attorneys. They are historically derived from Special Litigation Assistants, who were senior IRS attorneys focused on advising Exam on nondocketed, large cases. However, the IRS has begun awarding Senior Counsel positions to senior IRS attorneys within the SB/SE Division.

4. **The Special Assistant United States Attorney**: The "SAUSA" is an IRS Counsel attorney that has been deputized by the U.S. Attorney's Office to handle bankruptcy cases in federal bankruptcy courts. The SAUSA plan originated in Houston and is often called the "Houston Plan." Post-reorganization, the SAUSAs ended up in SB/SE, as most of the IRS's cases that end up in bankruptcy involve individuals or small businesses.

E. **Appeals:**

1. **The Appeals Officer**: Typically an experienced, former revenue agent; the Appeals Officer's job is to settle cases. They typically handle Protests from 30-day letters that are issued at the end of an examination. They also typically handle cases that are docketed in U.S. Tax Court. They also handle appeals of other matters, such as appeals from denials of penalty relief and appeals from denials of refund claims.

2. **The Settlement Officer**: The 1998 IRS Restructuring and Reform Act provided taxpayers with administrative appeal rights in collection-related matters. This resulted in a significant increase in Appeals' caseload. Collection Due Process (see I.R.C. §§ 6320 & 6330) and Collection Appeals Program cases are usually handled by a special kind of Appeals Officer called a "Settlement Officer." The Settlement Officer is typically a former revenue officer.

F. **Disclosure: The Disclosure Officer** handles disclosure matters. Before an IRS employee can disclose information in response to a taxpayer request, he or she will typically consult with a Disclosure Officer. Before an IRS employee can testify in court, he or she must obtain an authorization from a Disclosure Officer.

G. **Office of the Taxpayer Advocate** (sometimes called the Taxpayer Advocate Service): A **Local Taxpayer Advocate** is assigned to a case when a taxpayer files a Form 911, Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order). That person "jawbones" the local IRS function to do its job and resolve a problem. Sometimes that is ineffective, but a good **Local Taxpayer Advocate**, with good jawboning skills and the threat of elevation to the **National Taxpayer Advocate**, can sometimes get problems resolved.

Ethical Considerations in Dealing with Various IRS Personnel and Functions

A. **IRS Circular 230:** IRS Circular 230 (31 C.F.R., Subtitle A, Part 10) governs practice before the IRS. Circular 230, as well as various sections of the Internal Revenue Code and Treasury Regulations that establish penalties, set forth standards of conduct that

apply to persons who practice before the IRS. The easiest way to obtain a copy of Circular 230 is on the IRS website.

B. **Practice Before the IRS:** Generally, all dealings with the IRS on behalf of a client are considered by the IRS to constitute practice before the IRS, including preparing and submitting tax returns and claims for refund. Circular 230, §§ 10.2(a)(4) & (5), 10.3. There is currently a court case pending in the D.C. Circuit regarding whether the IRS can impose the requirements of Circular 230, including continuing education requirements, on persons who prepare returns or claims for refund who are not attorneys, CPAs or enrolled agents. *Loving v. Internal Revenue Service*, ___ F. Supp. 2d ___, 111 A.F.T.R. 2d 589, 2013-1 U.S.T.C. ¶ 50,156 (D.D.C. 2013); ___ F. Supp. 2d ___, 111 A.F.T.R. 2d 702, 2013-1 U.S.T.C. ¶ 50,171 (D.D.C. 2013); 111 A.F.T.R. 2d 1384 (D.C. Cir. 2013).

C. **Form 2848:** In order to represent a client before the IRS personnel and functions described above, one generally must file with the IRS a Form 2848, Power of Attorney and Declaration of Representative. Once on file with the IRS, data from Forms 2848 are maintained on a computer database known as the Centralized Authorization File or "CAF." There is a unit at certain IRS Service Centers called the "CAF Unit" that enters and maintains the data.

D. **Preparer Tax Identification Number:** In order to prepare and file tax returns and claims for refund, one must register with the IRS and obtain a Preparer Tax Identification Number or "PTIN." Circular 230 § 10.8(a). The PTIN must be renewed annually.

E. **Continuing Education Requirements:** The IRS attempted to impose continuing education requirements on all tax return preparers. Whether it can do so with respect to return preparers who are not attorneys, CPAs or enrolled agents is in litigation in the *Loving* case. Attorneys and CPAs are exempted by the IRS from continuing education requirements, because each are already subject to continuing education requirements in connection with having their professional licenses.

F. **Standards of Conduct:** Circular 230 (including by cross-reference to certain sections of the Internal Revenue Code and Treasury Regulations) provides standards of conduct for representing taxpayers before the IRS, including standards for different types of written advice, for preparation of tax returns and claims for refund, for conflicts of interest, and for due diligence and conduct before the IRS. *See* Circular 230, Subpart B. Failure to comply with these standards can result in the imposition of sanctions and penalties. *See* Circular 230, Subpart C. Before representing clients on federal tax matters, it is important to review Circular 230.

The IRS's "Internal" Sources of Guidance/Information

A. **The Internal Revenue Manual:** Oft-consulted parts include:

1. Part 4, Examining Process

2. Part 5, Collecting Process

3. Part 8, Appeals

4. Part 9, Criminal Investigation

5. Parts 30 through 39, which have commonly been referred to as the "Chief Counsel Directives Manual" or "CCDM."

B. **Integrated Data Retrieval System ("IDRS"):** IDRS consists of the IRS's multi-faceted, linked computer system. IDRS operates on a two-week cycle – i.e., every two weeks the system is updated to capture and reflect new entries that have been input onto the system by IRS personnel. Various reports and printouts can be generated from IDRS, most of which are internal to the IRS.

1. **IRS Processing Codes and Information (formerly titled "ADP and IDRS Information," commonly called the "ADP Code Book")**: This is an IRS-published reference book that contains definitions for the various transaction codes, status codes, and other codes that are utilized in IDRS. It is published annually, with few revisions from year to year. It is intended for internal use, but redacted editions have been made available to the public. The 2011, 2012 and 2013 editions now appear in the Electronic Reading Room on the IRS website at http://www.irs.gov/uac/Document-6209---ADP-and-IDRS-Information.

2. **Major Files on IDRS**:

   a. Individual Master File ("IMF")

   b. Business Master File ("BMF")

3. **Within IMF and BMF** are entity modules containing information on each taxpayer, and tax modules, each containing information on a particular tax return/tax period with respect to a particular taxpayer.

4. **IDRS Transcripts**: Various types of transcripts can be generated and printed off of IDRS. Three major ones are:

   a. **Account Transcript:** This is a plain-English transcript that can be ordered from the IRS Practitioner Priority Service at the toll-free number (866) 860-4259. It reflects information on the account for a particular taxpayer for a particular taxable period, such as the account balance, the date of return filing, assessments of tax, penalties and interest, payments and credits, and amounts abated or refunded.

   b. **TXMOD:** This is an internal-use IRS transcript reflecting information for a particular taxpayer for a particular taxable period. It is not in plain English, and is full of transaction, status and other codes. You need the ADP Code Book to be able to read a TXMOD; especially useful is Chapter 8 of the ADP Code Book, defining the various transaction codes. A TXMOD typically contains more information than a plain-English account transcript. It is useful if you are looking for pending transactions that have not yet posted to the system, or for certain codes, such as freeze codes, that the IRS deems too sensitive to reveal on plain-English account transcripts. You may or may not be able to obtain a TXMOD

from the Practitioner Priority Service, depending on who you reach when you call.

c. **ENMOD:** Reflects identifying information for the taxpayer – e.g., name, taxpayer identification number (SSN or EIN), address.

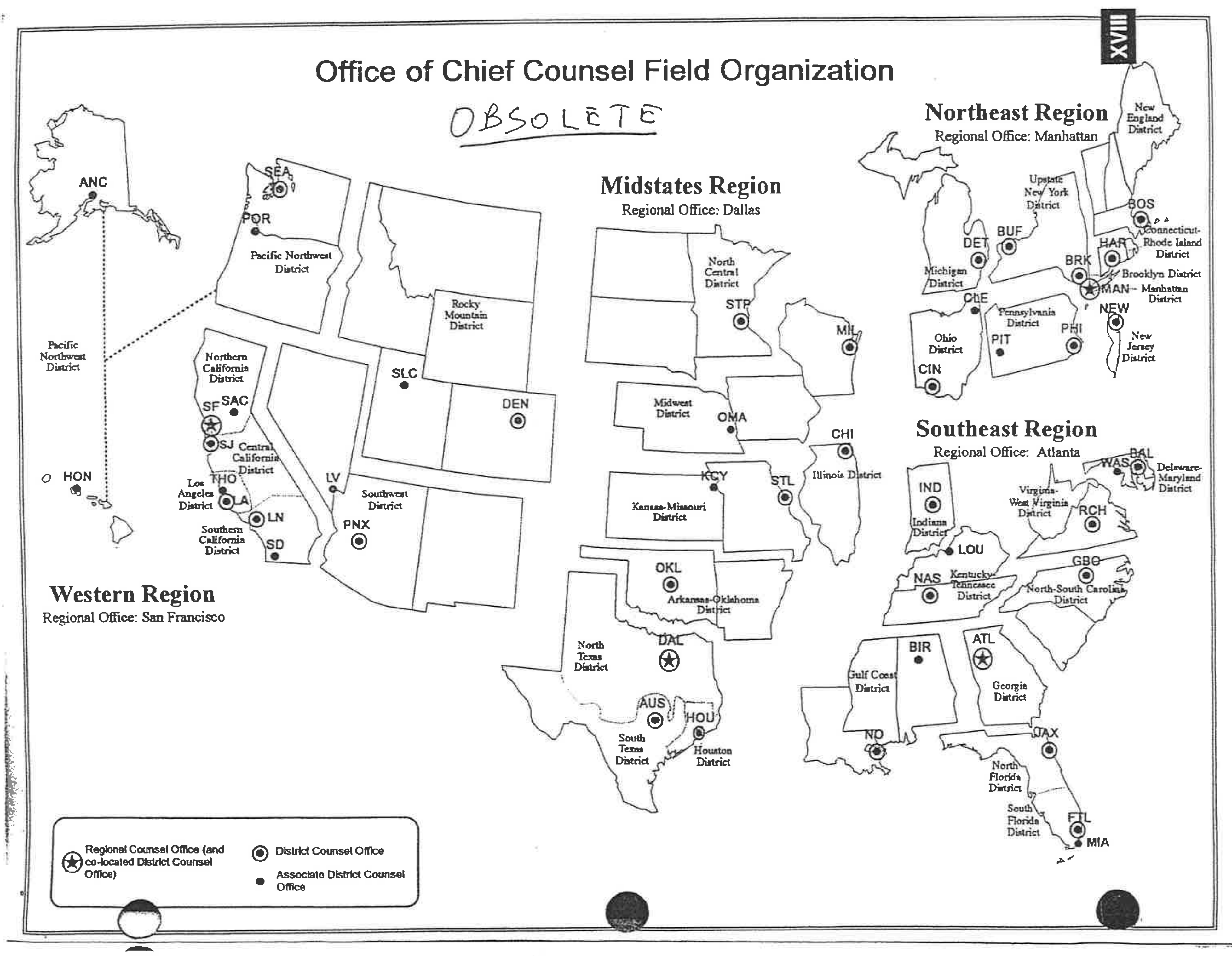
C. **TLCATS**: IRS Chief Counsel has a computerized case-tracking system called TLCATS that tracks tax litigation cases throughout the country.

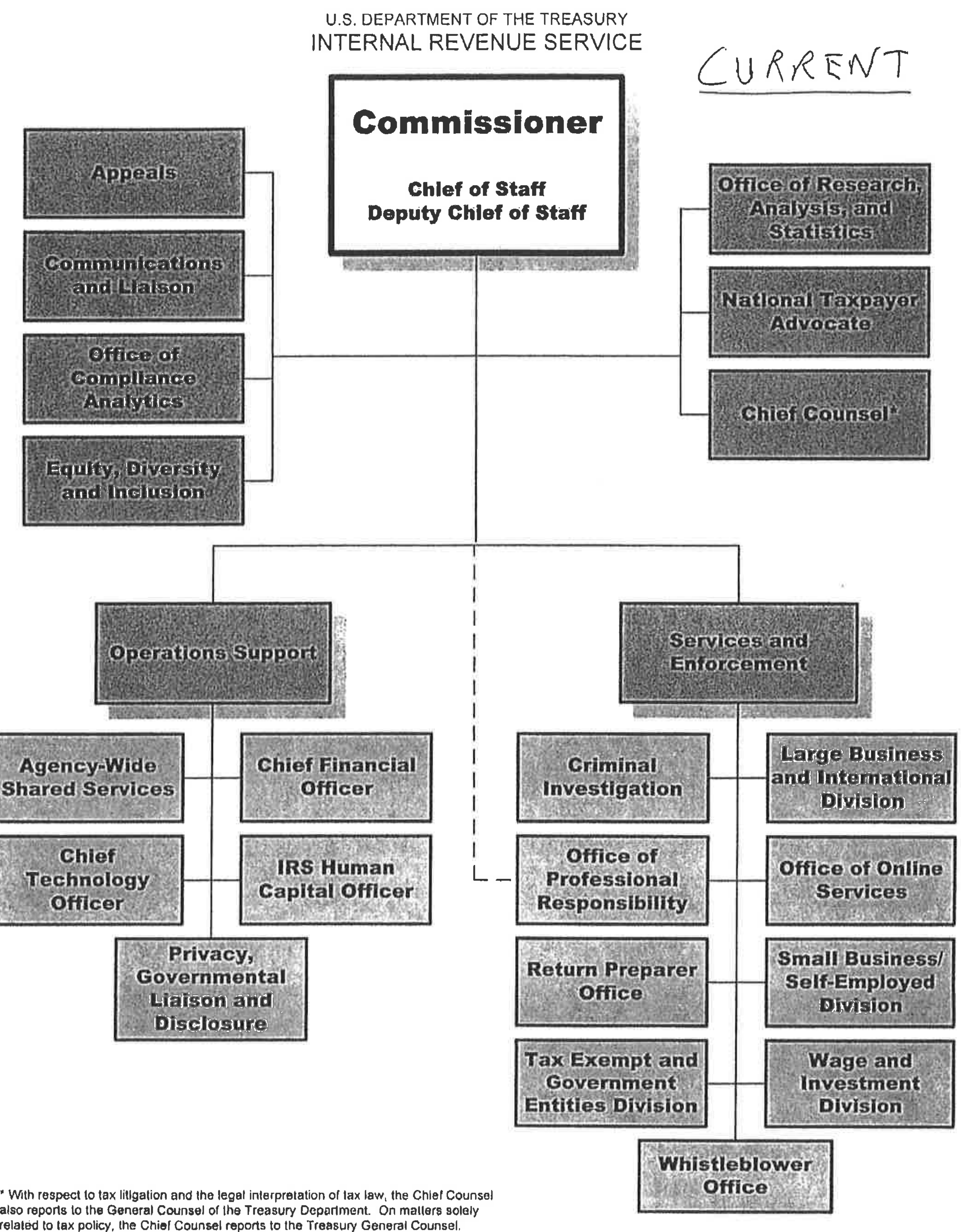
D. **Chief Counsel Advice**: This is advice provided by Chief Counsel to attorneys, agents, Service Centers, etc. under a variety of different names. By statute, Chief Counsel is supposed to redact taxpayer information and privileged information and release copies of Chief Counsel Advice; when released, it typically is published by the various commercial tax law databases.

IRS Circular 230 Disclosure:
To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the internal revenue code or (ii) promoting, marketing or recommending to another party any transaction or tax-related matter[s].

Office of Chief Counsel Field Organization

OBSOLETE





* With respect to tax litigation and the legal interpretation of tax law, the Chief Counsel also reports to the General Counsel of the Treasury Department. On matters solely related to tax policy, the Chief Counsel reports to the Treasury General Counsel.

Financial institutions
Energy
Infrastructure, mining and commodities
Transport
Technology and innovation
Life sciences and healthcare

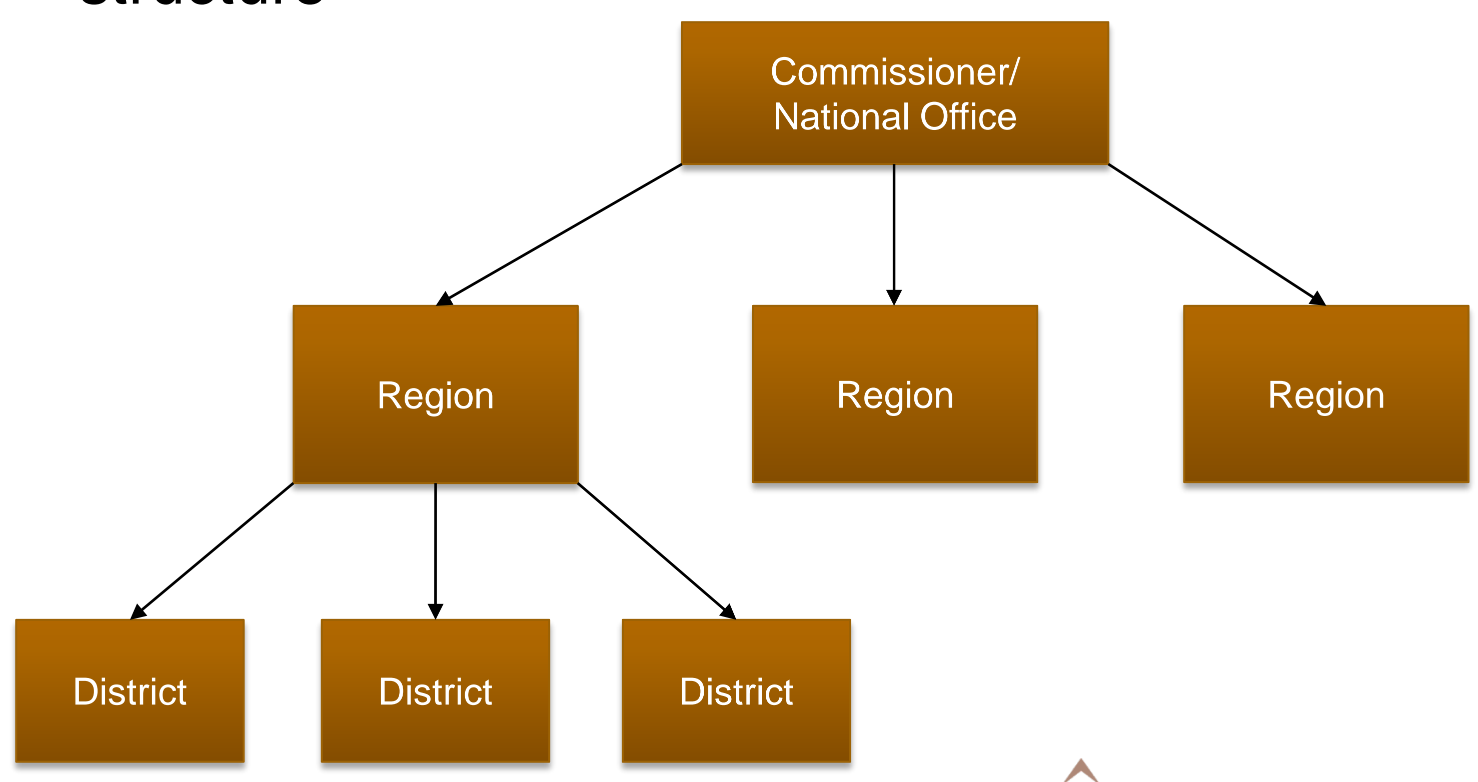
The IRS: A Former Insider's View of How It Is Organized and How It Works

Richard L. Hunn
Fulbright & Jaworski LLP
February 28, 2014

Organization

A. Historical Organization:

1. IRS was historically organized on a 3-tier, geographic structure



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Organization

A. Historical Organization:

2. Historically organized on a functional basis within National Office, Regions and Districts (National Office has additional functions)

Examination Division (“Exam”)

Collection Division (“Collection”)

Criminal Investigation Division (“CID”)

NORTON ROSE FULBRIGHT

Organization

A. Historical Organization:

3. IRS Chief Counsel
4. IRS Appeals
5. Service Centers
6. Disclosure
7. Taxpayer Ombudsman/Problem Resolution

Organization

B. IRS Restructuring and Reform Act of 1998

1. Section 1001:

   “The Commissioner of Internal Revenue shall develop and implement a plan to reorganize the Internal Revenue Service.”

2. Section 1102 (and Code Sections 7803 and 7811):

   Taxpayer Advocate

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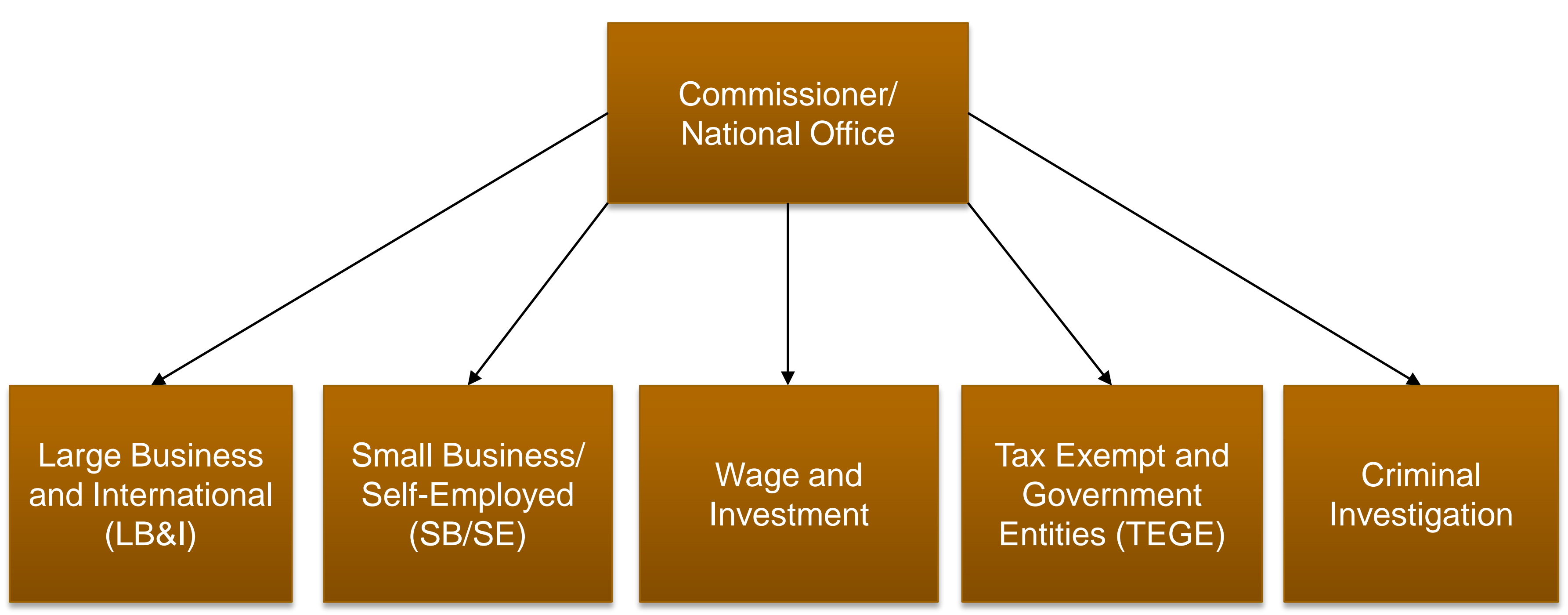
Organization

C. Current Organization:



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Organization

C. Current Organization:

1. IRS Chief Counsel
2. IRS Appeals
3. Functions
4. Service Centers
5. Disclosure
6. Taxpayer Advocate

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The Cast of Characters

A. Examination:

1. The Office Auditor
2. The Revenue Agent
3. The International Examiner
4. The Engineer
5. The Economist
6. The Attorney Examiner

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The Cast of Characters

B. Collection: The Revenue Officer

C. Criminal Investigation: The Special Agent

D. The Chief Counsel Attorneys:

   1. The Attorney (General Attorney or Docket Attorney)

   2. The Special Trial Attorney

   3. The Senior Counsel

   4. The Special Assistant United States Attorney

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The Cast of Characters

E. Appeals
   1. The Appeals Officer
   2. The Settlement Officer
F. Disclosure: The Disclosure Officer
G. Office of the Taxpayer Advocate
   1. Local Taxpayer Advocate
   2. National Taxpayer Advocate

Ethical Considerations in Dealing with Various IRS Personnel and Functions

A. IRS Circular 230

B. Practice Before the IRS

C. Form 2848

D. Preparer Tax Identification Number

E. Continuing Education Requirements

F. Standards of Conduct

The IRS's "Internal" Sources of Guidance/Information

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3. Within IMF and BMF are entity modules and tax modules

The IRS's "Internal" Sources of Guidance/Information

B. Integrated Data Retrieval System ("IDRS"):

   4. IDRS Transcripts

      a. Account Transcript

      b. TXMOD

      c. ENMOD

C. TLCATS

D. Chief Counsel Advice

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IRS Collections – Liens, Levies, Trust Fund Recovery: What to Do?

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The State Bar of Texas
Section of Taxation - Tax Law Survey in a Day
February 28, 2014
Cityplace, Dallas

Dustin Whittenburg

Dustin Whittenburg is a graduate of the Southern Methodist University Dedman School of Law (JD, cum laude, ’03) and New York University School of Law (LL.M.-Taxation, ’06). Mr. Whittenburg was awarded the Dean’s Scholarship and appointed an articles editor of the SMU Law Review Association.

After graduating from law school Mr. Whittenburg worked as a litigator at a Dallas, Texas based law firm for two years. He then attended New York University School of Law. After graduation he worked at Cox Smith Matthews, Incorporated where his practice focused on complex tax planning, federal and state tax controversies, counseling non-profit entities, and matters related to executive compensation. He has represented taxpayers during administrative appeals before the Internal Revenue Service and Texas Comptroller as well as in the United States Tax Court and Federal District Courts. Mr. Whittenburg is admitted to practice before the United States Tax Court, the Federal District Court of the Western District of Texas and the Federal District Court of the Northern District of Texas.

Prior to attending law school Mr. Whittenburg received a BBA in accounting and finance as well as a MS in accounting from Texas Tech University. He is a graduate of Randall High School in Amarillo, Texas. He is the son of Burk and Carol Whittenburg. His wife, Brooke Whittenburg, is a San Antonio native and daughter of Wayne and Cynthia Harwell.

Tax Law in A Day

Handling a Tax Controversy:

Audits, Appeals, Litigation and Collections

Dallas, Texas

February 28, 2014

Administrative Collections Procedures: Collection Due Process, Offers in Compromise and Installment Agreements and Trust Fund Recovery Penalties

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Collection Alternatives

- Full payment
- Extension to Pay
- Installment Agreement
- Partial Pay Installment Agreement
- Offer in Compromise
- Currently Not Collectible

Sample Collection Notices

- CP 14 – You have unpaid tax due for a particular period
- CP 21E – You owe money as a result of an audit adjustment
- CP 501 – "**You have unpaid tax for YEAR**" - You have a balance due on one of your tax accounts
- CP 503 – "**Second reminder. You have unpaid tax for YEAR**" - We have not heard from you and you still have an unpaid balance
- CP 504 – "**Notice of intent to levy – Intent to seize your property or rights to property**" - You have an unpaid amount due. If you do not pay the amount due immediately, the IRS will seize (levy) your state income tax refund

Installment Agreements

- IRM 5.14
- Interest and penalties continue to accrue
- User fee: $105 ($52 if you establish a direct debit agreement, and $43 if your income is at or below 250% of the Department of Health and Human Services poverty guidelines)
- No prepayment penalty
- The only time IRS can extend statute of limitations on collections is by agreement
- Non-compliance during installment agreement will result in default (CP 523)

Installment Agreements

- Methods to Request an Installment Agreement
  - On Line Payment Agreement
  - By phone - 800-829-1040 (individuals), 800-829-4933 (businesses)
  - By mail – Form 9465 (Request for Installment Agreement)
  - In person
- Taxpayers must submit a Form 433
- Methods to remit installment payments
  - Electronic Federal Tax Payment System (EFTPS)
  - Direct Debit
  - Payroll Deductions
  - Credit Card (watch service charge!)
  - Check or money order

Streamlined Installment Agreements

Balance due of $25,00 or less:

- Full paid within earlier of 72-mths or Collection Statute Expiration Date
- Compliant with all filing and payment requirements.
- Individuals who owe any type of tax
- Defunct businesses, including any type of entity and any type tax
- Operating businesses are limited to income tax liabilities only

Balance due of $25,001 to $50,000:

- Full paid within earlier of 72-mths or Collection Statute Expiration Date
- Compliant with all filing and payment requirements.
- Individuals who owe any type of tax
- Businesses limited to defunct sole proprietors who owe any type of tax
- You must enroll in a Direct Debit Installment Agreement.
- A limited amount of financial information may be required

In Business Express Trust Fund - IA

- Small businesses with employees can qualify for an In-Business Trust Fund Express Installment Agreement
- No financial statement or verification required
- Taxpayer must owe $25,000 or less
- Balance must be full paid within earlier of 24-months or prior to the Collection Statute Expiration (CSED)
- Must enroll in a Direct Debit installment agreement (DDIA) if the amount you owe is between $10,000 and $25,000
- Must be currently compliant with all filing and payment requirements
- IRM 5.14.7.4(7) (IBTFIA guidelines)

Forms 433

- Form 433-F (Collection Information Statement) (June 2010)
- Form 433-A (Collection Information Statement for Wage Earners and Self-Employed Individuals) (December 2012)
- Form 433-B (Collection Information Statement for Businesses) (December 2012)

Collection Financial Standards

- http://www.irs.gov/individuals/article/0,,id=96543,00.html
  - National Standards – Food, Clothing and Other Items
  - National Standards – Out-of-Pocket Health Care
  - Housing and Utilities Standards
  - Transportation Standards
- Allowable expenses – IRM 5.15.1.7
- Reasonable Collection Potential
  - http://www.irs.gov/taxtopics/tc204.html
  - Amount of money IRS thinks it can collect from a taxpayer for tax debts

Partial Pay Installment Agreement

- IRC § 6159 and IRM 5.14.2 (03-11-2011)
- Allowed when taxpayer has some ability to pay, but is unable to full pay amount due by CSED
- Partial Pay Installment Agreements (PPIA) allowed by *The American Jobs Creation Act of 2004*
- In most cases, taxpayer will be required to use equity in assets to pay liabilities
- Taxpayer must submit a Form 433
- Conditional expenses are not allowed for PPIA

Offer in Compromise

- IRC § 7122
- Treasury Regulation § 301.7122-1
- IRM 5.8.1 (06-24-2013)
- Grounds to accept Offer in Compromise
  - Doubt as to Collectibility (DATC)
  - Doubt as to Liability (DATL)
  - Effective Tax Administration (ETA)
    - Tax Policy
    - Economic Hardship (Special Circumstances)

Offer in Compromise

- Form 656-Offer in Compromise
  - Contract between Taxpayer and IRS
  - Identify Type of Tax and Tax Years
  - Payment terms (Section IV) are only part of agreement
  - Taxpayer should understand other terms (Section V)
- For OIC DATC or ETA - Form 656-A-Income Verification
  - Low income Taxpayers (< 250% FPL) do not have to pay $186 processing fee, the 20% lump sum fee, or periodic payments
- Form 656-B-Offer in Compromise Booklet
- Forms 433A (OIC) and 433B (OIC)

Offer in Compromise

- Payment Terms
  - **Lump sum cash offer** – requires 20% down payment and remainder paid in 5 or fewer payments from date of acceptance
  - **Lump sum cash offer** – requires 20% down payment and remainder paid in 6 to 24 payments from date of acceptance
  - **Periodic payment offer** – requires 1/24 of amount offer with Form 656, and payments each month for 24 months while offer is pending

Offer in Compromise

- Statute of limitations for assessment and collection is suspended while an Offer is pending
- IRS will keep any refunds due to taxpayer for any tax periods through the calendar year in which IRS accepts Offer
- If Offer is rejected, IRS will keep deposit and periodic payments and apply those to the outstanding liabilities
- If Offer is accepted, Taxpayer must remain in compliance with all tax filing and payment requirements for 5 years or until Offer is paid in full, whichever is *later*. If not, Offer is defaulted and liability is reinstated

Offer in Compromise
Fresh Start Provisions (IR 2012-53)

- Focus on financial analysis used to determine which taxpayers qualify for an OIC
- Revising the calculation of taxpayer's future income
  - RCP considers only 1 year of future income for Offers paid in 5 or fewer months, down from 4 years
  - RCP considers 2 years of future income for Offers paid in 6 to 24 months, down from 5 years
  - All Offers must be fully paid within 24 months of the date the offer is accepted

Offer in Compromise

Fresh Start Provisions (IR 2012-53)

- New definition of dissipated asset to calculate RCP
- Equity in income producing assets generally will *not* be included in RCP for on-going businesses.
- Allowable Living Expense standards
  - The National Standard miscellaneous allowance has been expanded to include additional items such as credit card payments and bank fees and charges
  - Allow payments for loans guaranteed by the federal government for taxpayer's post-high school education.
  - Allow payments for delinquent state & local tax based on percentage basis of tax owed to the state and IRS

Currently Not Collectible

- IRM 5.16.1.1 (05-22-2012)
- Policy Statement 5-71 provides the authority for reporting accounts currently not collectible (CNC)
- Transaction Code 530
- Notice of Federal Tax Lien will generally be filed
- IRS will generally follow up with taxpayers to monitor ability to pay
- Statute of limitations continues to run
- Penalties and interest continue to accrue

Final Notice of Intent to Levy

- Letter 1058 and appeal rights (Pub. 4165)
- CP90 or 91/CP297 or 298 – Final notice as to federal payments or benefits
- Final Notice must be sent to taxpayer's last known address – *Graham v. Commissioner*, T.C. Memo. 2008-129
- Must be sent by certified mail, return receipt
- Appeal must be filed within 30 days of the date on the Final Notice – IRC § 6330
- Form 12153 – Request for CDP hearing
- Best practice: send appeal with proof of mailing

Notice of Federal Tax Lien Filing

- Letter 3172, copy of Notice of Federal Tax Lien and appeal rights
- Must be sent by IRS not more than 5 business days after the day the IRS files the Notice of Federal Tax Lien – IRC § 6320(a)(2)
- Appeal must be filed within 30 days of date of Letter 3172 (deadline should be reflected on Letter 3172)
- Must establish basis for release or withdrawal
  - Grounds for Release or Withdrawal – Pub. 1450
  - Application for Discharge – Pub. 783
  - Application for Subordination – Pub. 784

Collection Appeals

- Collection Appeal Program
  - Publication 1660 and Form 9423
- Collection Due Process hearings
- Equivalency Hearings

Collection Due Process

- **Created** by IRS Restructuring & Reform Act 1998
- **Purpose**: To give taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first Notice of Federal Tax Lien for a particular tax liability
- **Hearing**: Allows taxpayer to raise issues relating to the collection methods, propose collection alternatives, or challenge the liability (in limited circumstances)

Collection Due Process

- One hearing per type of tax and tax period for liability listed on the Notice of Federal Tax Lien Filing or Final Notice of Intent to Levy
- Right to judicial review of a determination following a CDP hearing applies to the first Notice received for a particular period

Collection Due Process

- Hearing:
  - Telephone conference (most common)
  - Face-to-face conference – non-frivolous, in compliance
    - *Keene v. Commissioner*, 121 T.C. No. 2, 14 (2003)
  - Recorded conference – IRC § 7521(a)
    - Advance request, taxpayer's expense, taxpayer's equipment
- Issues to Raise:
  - Innocent spouse relief
  - *De novo* review of the tax, penalty or interest assessed
    - Only if no prior opportunity to challenge
    - *Montgomery v. Commissioner*, 122 T.C. No. 1
  - Collection alternatives

Collection Due Process

- Notice of Determination:
  - Verification that IRC requirements are satisfied
  - Outline issues and defenses raised by taxpayer
  - Discuss whether proposed collection alternative balances need for efficient collection while ensuring that collection action be no more intrusive than necessary
  - IRC § 6330(c)(3)
- Right to Judicial Review
  - If timely filed CDP appeal
  - Petition to US Tax Court due within 30 days

Disqualified Employment Tax Levy

- IRC § 6330(h) - exception to the right to a CDP hearing
- A disqualified employment tax levy is any levy in connection with the collection of employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a CDP hearing with respect to unpaid employment taxes arising in the most recent 2-year period before the beginning of the taxable period with respect to which the levy is served.
- Employment taxes means any tax under chapter 21, 22, 23, or 24

Taxpayer Advocate Service

- Independent organization within the IRS
- Helps taxpayers resolve problems with the IRS
- Recommends changes that will prevent the problems in the future
- http://www.irs.gov/advocate/index.html
- Grounds for TPA Assistance
  - Economic harm
  - Immediate threat of adverse action
  - Threat of significant costs
  - Threat Irreparable injury or long-term harm
  - Delay of more than 30 days
  - No response or resolution on promised date
  - System failed to operate as intended or failed to resolve problem
  - Administration of tax law raises question of equity and fairness
  - Public policy warrants taxpayer assistance

Taxpayer Advocate Service

- Contacting TAS
- Form 911
- What to expect from TAS
- Operations Assistance Request (OAR)
- Taxpayer Assistance Order (TAO)
- Systemic Advocacy

Trust Fund Recovery Penalties

- IRC § 7501 states that withheld taxes "shall be held to be a special trust fund interest for the United States."
- IRC § 6672 provides:
  - Any person required to collect, truthfully account for, and pay over any tax imposed by this title
  - who willfully fails to collect, account for or pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof,
  - shall be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

Trust Fund Recovery Penalties

- Statute of Limitations
  - 3 years from the later of April 15 of the year following the year the liabilities accrued, or the date the return for the period at issue was actually filed. IRC § 6501
  - IRC § 6672(b)(3)- if a Notice of Proposed Assessment is issued before the expiration of the period of limitations on assessment, the period of limitations shall not expire before the later of:
    - 90 days after the notice is mailed/delivered
    - if there is a timely protest, 30 days after the Secretary makes a final determination

Trust Fund Recovery Penalties

- More than one person can be assessed with the trust fund recovery penalty for the same liability, and persons responsible are jointly and severally liable for delinquent taxes. *McCray v. United States, 910 F.2d 1289 (5th Cir. 1990)*
- The IRS does not have to exhaust its remedies against the employer or other responsible persons before going after a particular responsible person

Trust Fund Recovery Penalties

- Tests to determine if someone is subject to IRC § 6672:
  - Whether party had a duty to account for, collect and pay over trust fund taxes (i.e., "responsible person")
  - Whether they willfully failed to perform that duty
- Willfulness, as used in IRC § 6672, does not require fraudulent intent or evil purpose, only
  - Knowingly, or intentionally disregarding the statutory provisions
  - Actual or constructive knowledge that taxes were unpaid. *Turpin v. United States*, 970 F.2d 1344 (4th Cir. 1992).

Trust Fund Recovery Penalties

- Factors considered to determine willfulness include (IRM 8.25.1.4.2 (12-07-2012)):
  - Whether the responsible person had knowledge of a pattern of noncompliance as delinquencies accrued;
  - Whether the responsible person received prior IRS notices that returns were not filed, or were inaccurate, or that employment taxes had not been paid;
  - Actions taken by the responsible person to ensure its Federal employment tax obligations have been met after becoming aware of the tax delinquencies; and
  - Whether fraud or deception was used to conceal the nonpayment of tax from the responsible person.

Trust Fund Recovery Penalties

- Unencumbered Funds Theory:
  - If funds are available after a responsible person learns of the outstanding liabilities, the failure to remit those unencumbered funds to the IRS may result in liability for the trust fund recovery penalty.
  - The willfulness element is satisfied as a matter of law if a responsible officer fails to "use all current and future unencumbered funds available to the corporation to pay [its] back taxes," after he becomes aware of the corporation's tax liability. *Erwin v. United States*, 591 F.3d 313, 326 (4th Cir. 2010).

Trust Fund Recovery Penalties

- Common targets of the trust fund recovery penalty:
  - Owners of employer
  - Officers of employer
  - Bookkeepers
  - Payroll clerks
  - Accountants
  - Payroll Service Providers (PSP)
  - Professional Employer Organization (PEO)

Trust Fund Recovery Penalties

- The investigation.....
  - To determine who is assessed with the penalty, a revenue officer conducts an investigation, including (IRM 5.7.4.2 (06-26-2012))
  - Form 4180, *Interview with Individual Relative to Trust Fund Recovery Penalty* (IRM 5.7.4.2.1 (08-05-2013))
  - Summons – financial records, business records, bank signature cards, cancelled checks, loan applications, employment tax returns, etc.
  - Collectibility determination (IRM 5.7.5 (06-28-2011))

Trust Fund Recovery Penalties

- Proposing the Assessment
  - When the revenue officer identifies the responsible persons, a Letter 1153, Notice of Proposed Assessment, must be issued to each individual. IRC § 6672(b)(1); IRM 8.25.1.5(4) (12-07-12)
  - The notice must advise the party against whom the penalty is asserted of the proposed assessment, the amounts at issue (listed on page 4 of the Form 4183 (chart of trust fund liabilities)), and the right to appeal the proposed assessment by filing a protest within 60 days from the date on the Letter 1153 (75 days if the letter is addressed outside the United States). IRC § 6672(b)(2)

Trust Fund Recovery Penalties

- If the party agrees to the assessment, they can sign the Form 2751, *Proposed Assessment of the Trust Fund Recovery Penalty*
- If the party disagrees, they may:
  - Request a manager conference
  - Request Fast Track Mediation, IRM 8.26.10 (09-28-2012)
  - File a timely appeal (timely mailing is timely filing)
- If no appeal is filed, the penalty will be assessed
- If an appeal is filed, the case is transferred to the Appeals Office for consideration

TFRP Payment and Refund Claims

- A taxpayer is generally required to pay the full amount of tax assessed for the period in question before filing a refund claim or initiating a refund suit. *Flora v. United States,* 362 U.S. 145, 177 (1960).
- Employment taxes and the trust fund recovery penalty are "divisible" taxes and therefore, not subject to the full payment rule. *See* IRC § 6331(i)(2); *Steele v. United States,* 280 F.2d 89, 90-91 (8th Cir. 1960) (full payment rule is not applicable to employment taxes because they are divisible into separate taxes for each employee).

TFRP Payment and Refund Claims

- Taxpayer must pay the portion of a trust fund recovery penalty that equals the amount due for a single employee for the period at issue. *See* IRM 5.7.7.4 (07-30-2010).
- *Kaplan v. United States, Fed. Cl.*, 2013 WL 5568724 (Oct. 9, 2013) ($100 estimate insufficient); *William Kramer & Assoc., LLC v. United States,* 2008-2 USTC ¶ 50,611 (M.D. Fla. 2008) (dismissed where only employer share of FICA was paid)
- Once payment is made, taxpayer must file a separate Form 843 (Claim for Refund & Request for Abatement) for each tax period and type of tax or penalty. IRC § 7422(a); Treas. Reg. § 301.6402-2(d); IRM 34.5.2.1 (08-11-2004).

TFRP Payment and Refund Claims

- Form 843 serves as both a claim for refund and a request to have the unpaid portion of the divisible tax abated.
- The claim for refund must include each ground upon which a refund is claimed and facts sufficient to establish the grounds for allowance. Treas. Reg. § 301.6402-2(b)(1).
- Only payments made within the two years prior to the claim will be considered for refund. IRC § 6511(a).

TFRP Litigation

- A taxpayer must wait to initiate refund litigation until at least 6 months after refund claim is filed with IRS (unless claim is rejected within those 6 months). IRC § 6532(a)(1).
- If a refund claim is disallowed, the Service will issue a certified letter (Letter 3784) to indicate disallowance of the claim ("Notice of Claim Disallowance") and to notify the taxpayer of the 2-year period to file a suit.
- Taxpayer may file an administrative appeal within 30 days of the date of the Notice of Claim Disallowance, but a timely appeal will not extend the 2-year period.

THANK YOU!!

Employee Benefits – Basic Overview and Effect of *Windsor*

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Concentration

Executive compensation, employee benefit plans, fiduciary matters

Summary

Rob Fowler practices primarily in the area of employee benefits. He has broad experience in the design and implementation of employee benefit plans, including multiemployer plans and related tax-qualification requirements, reporting and disclosure matters, prohibited transaction issues and other fiduciary concerns.

Additionally, Mr. Fowler advises clients regarding employee stock ownership (ESOP) transactions, and regularly advises clients regarding the employee benefits aspects of mergers, acquisitions and joint ventures and regarding the integration of plans and arrangements following a transaction. He has extensive experience in the negotiation and drafting of employment and consulting agreements, restrictive covenants, clawback arrangements, golden parachute arrangements and other executive compensation and incentive programs, including the various forms of equity compensation arrangements and regularly advises clients on issues under Sections 409A and 162(m) of the Internal Revenue Code. He has helped design and implement compensation and benefits arrangements for numerous master limited partnerships (MLPs). He also handles filings with the Pension Benefit Guaranty Corporation, Department of Labor and Internal Revenue Service and has been involved in several ERISA litigation matters.

Following graduation from law school, Mr. Fowler served as a law clerk to the Honorable Edith Jones of the United States Court of Appeals for the Fifth Circuit.

Representative Engagements

- Negotiation of the employee benefits provisions in a large public company merger in the oilfield services industry, and assisted with benefits integration, executive compensation and retention planning post-merger
- Negotiation of employee benefits aspects of sale of retail electric provided in which ESOP was a significant selling shareholder
- Representation of multiemployer pension and welfare plan trustees in plan administration, plan design and

fiduciary issues

- Advised clients regarding compensation and benefits structuring in connection with initial public offering of MLPs
- Represented management team in the negotiation of equity incentive and other compensation arrangements in connection with private equity purchase
- Negotiation of the employee benefits provisions in a client's sale of a subsidiary
- Negotiation of the employee benefits provisions of a joint venture agreement between two oilfield services companies and providing advice regarding follow-up issues in implementation of the joint venture structure
- Design and implementation of several employee stock ownership plans
- Addressed equity compensation adjustments and related matters in public company split-off
- Representation of a major oil company in a class action suit alleging that independent contractors were common-law employees entitled to benefits
- Representation of an investment committee in a class action suit over employer stock issues in a 401(k) plan
- Negotiation of numerous employment and separation agreements on behalf of employers and executives
- Advised clients regarding design of equity incentive arrangements, including restricted stock, phantom stock, stock units, stock options and stock appreciation rights and preparation of related documentation
- Advised client regarding various aspects of pension plan termination

Education and Honors

J.D. (*with high honors*), University of Chicago Law School, 1996
Order of the Coif

B.S., mechanical engineering, Texas A&M University, 1993

Recommended in *The Legal 500 U.S.*, 2013

Listed in *The Best Lawyers in America*, 2012 - 2013

Recognized as a "Texas Rising Star," 2004 - 2009

Admissions and Affiliations

State Bar of Texas

United States Court of Appeals for the Fifth Circuit

American Bar Association, Tax Section

Houston Bar Association

Chairman, Houston Young Lawyers Foundation, Board of Trustees, 2006-2007

Basic Overview and Effect of *United States v. Windsor* on Employee Benefits

Rob Fowler
Baker Botts L.L.P.

Who qualifies as a "spouse" for purposes of the rules affecting employee benefit plans is an important concept, as it determines rights and obligations of individuals and employee benefit plan sponsors and administrators in many areas. This paper focuses on the employee benefits-related effects of the recent US Supreme Court decision in *United States v. Windsor* to strike down the federal law which had limited the definition of "marriage" and "spouse" to opposite-sex marriages and their participants, as well as subsequent Internal Revenue Service ("IRS") and Department of Labor ("DOL") guidance.

The Defense of Marriage Act and *Windsor*

Enacted in 1996, Section 3 of the Defense of Marriage Act ("DOMA") defined marriage for purposes of federal law as a legal union between a man and a woman as husband and wife. In addition, Section 2 of DOMA provided that no state was required to recognize a same-sex marriage performed in another state. Before enactment of DOMA, there was no definition of marriage for purposes of federal law, which looked exclusively to state law to determine marital status. Of course, it is easy to forget now that at the time DOMA was passed, there were no states performing same-sex marriages.

As states began to provide for same-sex marriages, legal challenges to the constitutionality of DOMA began to percolate through the system, culminating with the June 26, 2013 Supreme Court decision in *United States v. Windsor*, 570 U.S. __, 133 S.Ct. 2652 (2013). In *Windsor*, the surviving spouse in a same-sex marriage (conducted in Canada and recognized in the state of New York) was denied the benefit of the unlimited marital exemption under the estate tax, as under DOMA she was not a spouse for purposes of any federal law, including the estate tax exemption.

The Supreme Court ultimately held that Section 3 of DOMA was unconstitutional on equal protection grounds, concluding that same-sex marriage participants were impermissibly denied the same rights afforded to opposite-sex marriage participants. The *Windsor* decision was effective July 23, 2013 (25 days after issuance). Section 2 of DOMA remains federal law, thus states may still refuse to recognize same-sex marriages performed in other states. The full effect of *Windsor*'s action with respect to Section 3 of DOMA is still unfolding.

IRS and DOL Guidance on *Windsor*.

To their credit, both the IRS and DOL undertook to issue guidance to taxpayers as to the effect of the *Windsor* decision on the operation of employee benefit plans. In Revenue Ruling 2013-17, the IRS determined that for purposes of any employee benefit plan requirement with respect to married participants or the rights of a spouse, husband or wife, federal law would follow a "state of celebration" rule, whereby whether a marriage was recognized was determined based on the law of the state (or country) in which the marriage was celebrated. The IRS

considered a possible "state of residence" rule, but determined that would impose too much of a burden on employers with multi-state operations.

Thus, an employer or plan administrator must, for purposes of any requirement related to a spouse under the internal revenue code, consider an employee or participant to be married if he or she is validly married in the state or country in which the marriage was entered into, even if the employee's state of residence or the employer's state of operation does not recognize the validity of such marriage. Civil unions and domestic partnerships, regardless of whether same- or opposite-sex, are not recognized as a marriage under the rules.

Tax-qualified retirement plans must treat a same-sex spouse as a spouse for purposes of the various Internal Revenue Code ("Code") provisions that require such plans to give particular benefits or preference to spouses. Numerous requirements under Code Section 401 are implicated in connection with notices or distributions to a "spouse." This also means that tax-free benefits can be provided to same-sex spouses under the following Code sections:

- 106 (health care),
- 117 (qualified tuition reduction),
- 119 (means and lodging for the convenience of the employer),
- 125 (cafeteria plans),
- 129 (dependent care assistance plans) and
- 132 (fringe benefits).

By its terms Revenue Ruling 2013-17 is effective from September 16, 2013 forward.

Similarly, in DOL Technical Release 2013-04, the DOL announced a "state of celebration" approach for purposes of any use of the word "marriage", "spouse" or similar term in Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). The DOL did not address what effect, if any, *Windsor* or its guidance has on periods prior to the decision or the issuance of the technical release.

On December 16, 2013, in Notice 2014-1, the IRS issued additional guidance specific to Section 125 cafeteria plans. In particular, the *Windsor* decision is considered a change in status event for those married in a same-sex marriage as of June 26, 2013 or after, and special transitional relief was provided for the effective date of a mid-year election change based on this change in status (essentially recognizing that such changes should be made effective as of the later of December 16, 2013 (or a reasonable time thereafter) or the date otherwise effective under the plan). Employers must also treat coverage elections for a same-sex spouse as a pre-tax election and the notice gives employees a roadmap to apply for refunds if appropriate. Expenses of a same-sex spouse may be reimbursed under a flexible spending account effective as of the plan year that includes the *Windsor* decision. Similarly, same-sex spouse are subject to the same family contribution limits as opposite-sex spouses under the health flexible spending account or

dependent care flexible spending accounts. Plan amendments to allow election changes that were not previously allowed may be made as late as the end of 2014 for calendar year plans, retroactive to January 1, 2013.

Impact on Tax-Qualified Retirement Plans

Any requirement related to a spouse or a married participant under the Code or ERISA is now equally applicable to a same-sex spouse. Thus, for example, qualified joint and survivor annuity requirements, which ensure that a spouse receives at least a minimum survivor annuity unless he or she makes a knowing and voluntary waiver, will apply to same-sex spouses. In addition, the special spousal rules related to hardship distributions, rollover distributions and minimum required distributions will apply to same-sex spouses. Finally, a same-sex spouse may now apply for a qualified domestic relations order dividing a tax-qualified retirement account in connection with divorce.[1]

The IRS has not yet provided a timeline for required plan amendments, if any, necessary as a result of the *Windsor* decision and subsequent IRS guidance. Many plans simply use the term "spouse" without further definition, and thus may not need to be amended. Other plans specifically incorporate a reference to DOMA or repeat its statutory language within the plan document.

In any event, operationally, it is clear that same-sex spouses should be treated the same as opposite-sex spouses from September 16, 2013 onward for purposes of all qualified retirement plan requirements relating to spouses. Plan administrators should take action to review their enrollment materials and other participant communications to be sure they are up to date for current requirements with respect to same-sex spousal benefits, and will need to be proactive in certain circumstances to ensure that spousal disclosure and consent requirements are met.

One major unanswered question relates to the retroactive effect of the *Windsor* decision on qualified plans. For example, if a same-sex spouse was denied a death benefit under a plan in favor of another beneficiary while DOMA was in effect, can that surviving spouse now pursue a claim for benefits? Does it make a difference if the benefit was already paid to another person? Should there be a different rule for defined contribution plans -- where there is only one account balance to pay on death -- versus a defined benefit plan, where there is a trust for all benefits from which the benefit could potentially be paid?

Qualified pension plans are required to provide pension benefits to married participants in the form of a joint and survivor annuity unless the participant's spouse waives that protection. What if, prior to DOMA's repeal, a pension plan began a single life annuity pension stream to a participant who was in a same-sex marriage -- can the participant retroactively choose a joint and survivor pension? What if the person has already died and no survivor benefits were payable?

[1] Participants who live in a state that does not recognize their same-sex union celebrated in another state may have to resort to their state of celebration (or other state recognizing a same-sex marriage) to obtain a divorce. This may present practical difficulties, as many states have residency requirements before jurisdiction is available for a court to issue a divorce decree.

The IRS has not yet provided guidance on the retroactive effect of *Windsor* on qualified plans. Of course, IRS guidance would be critical to deciding what steps are necessary to maintain plan qualification, and not necessarily dispositive of an individual claimant's substantive rights under ERISA, but most practitioners expect its pronouncements to be influential on issues of participant rights as well. The DOL could also opine on these topics, and its authority does extend to participants' and beneficiaries' substantive rights under ERISA. For now, these and many other unanswered questions remain concerning the impact of *Windsor* on qualified retirement plans and participant and spousal substantive rights under ERISA.

Impact on Health and Welfare Plans

As discussed above, most of the immediate impact of *Windsor* results in taxpayer-favorable outcomes (e.g., a same-sex spouse now can be provided coverage under a group health plan or health flexible spending account on a tax-free basis). Plan sponsors should immediately begin to implement withholding procedures that align with this new guidance, paying particular attention to state law rules that might lead to a different result for purposes of any state income tax withholding requirements.

To date, states that allow same-sex marriages include: California, Connecticut, Delaware, Hawaii (12/2/13), Iowa, Illinois (7/1/14), Maine, Massachusetts, Maryland, Minnesota, New Jersey (10/21/13), New Hampshire, New Mexico (12/19/13), New York, Rhode Island, Vermont, Washington and the District of Columbia,[2] and states that prohibit same-sex marriages and do not recognize marriages in other states are: Alabama, Alaska, Arizona, Arkansas, Florida, Georgia, Idaho, Indiana, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, Nebraska, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia, Wyoming. Thus, for example, an employer may be required to withhold on the value of medical coverage provided to a same-sex spouse in Oklahoma (who may have been married in a ceremony in New York), even though for federal income and employment tax purposes the value of such coverage will be excluded pursuant to Code Section 106.

As to retroactivity, at least on the health and welfare front there is some guidance to individual taxpayers: the IRS has indicated that taxpayers may rely on its rulings retroactively to claim a refund for overpayment of taxes related to employer-provided health or fringe benefits that would have been excludible from income based on marital status if same-sex marriages had been recognized under federal law.

Note that federal law will not necessarily require that employers provide same-sex benefits following *Windsor*. Other than rules under COBRA (which provide for rights to continued coverage in the event of divorce to the extent a same-sex spouse is a plan participant) or HIPAA (which provide special enrollment rights to spouses in certain circumstances), there are few regulatory rules that will impose mandatory coverage or compliance requirements on sponsors of health and welfare plans. Federal law does not generally require spousal coverage, and thus, in theory, an employer may be able to provide coverage to some, but not all, spouses.

[2] The status of same-sex marriage in Utah is still an open question due to ongoing litigation. Outside the U.S., same-sex marriages have been allowed in: Argentina, Brazil, Canada, Denmark, England (2014), France, Iceland, Spain, South Africa, Sweden.

However, given that there are no federal requirements directly addressing the point, some employers may attempt to provide spousal benefits to only opposite-sex spouses. Opponents of this approach will argue that this type of arrangement discriminates on its face based on the sex of the participant's spouse, in violation of equal protection and Title VII of the Civil Rights Act, which prohibits discrimination on the basis of sex. There has already been litigation initiated on this front.

Conclusion

While the *Windsor* decision and subsequent regulatory guidance have resolved many issues related to how employee benefit plans should treat same-sex spouses going forward, there are still many unanswered questions, particularly about the retroactive effect of *Windsor*, that will only be answered through additional regulatory guidance and litigation.

February 3, 2014

Basic Overview and Effect of *Windsor* on Employee Benefits

Baker Botts L.L.P.

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Road Map for Today

- Defense of Marriage Act
- *US v. Windsor*
- IRS and Other Agency Guidance
- Employee Benefits Post-*Windsor*
- State Tax Treatment
- Post-*Windsor* Litigation
- Next Steps: What Should Employers Do Now to Prepare for a Post-*Windsor* World of Employee Benefits?

Background - DOMA

- **Before 1996 and DOMA, "marriage" or "spouse" was not defined for Federal law purposes**
  - Instead, Federal law - including Internal Revenue Code ("**Code**") and Employee Retirement Income Security Act ("**ERISA**") - looked to State law to define who is a "spouse" and what is a "marriage"
  - Thus, pre-DOMA, same-sex marriage allowed by a State should be a "marriage" and same-sex spouse a "spouse" for Federal law purposes in that State
  - Concern was that a State that didn't recognize same-sex marriage may have to recognize another State's same-sex marriage under the Full Faith & Credit Clause of the US Constitution

Background - DOMA

- **Enacted in 1996, DOMA has two substantive sections:**
  - **Section 2** provides exception to Full Faith & Credit Clause of US Constitution (i.e., no State must recognize a same-sex marriage of another State)
  - **Section 3** provides that for Federal law purposes "marriage" means a legal union between one man and one woman as husband and wife and "spouse" refers only to an opposite-sex husband or wife

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Background - DOMA

- Under **Section 3** of DOMA, same-sex spouses:
  - Do not enjoy the spousal protections and rights under qualified retirement plans and welfare benefits extended by employers to same-sex spouses are taxable to employee unless same-sex spouse can qualify as a tax dependent under Code Section 152
  - Not treated as spouse for Federal income and estate tax purposes
- Other benefits, such as FMLA, COBRA and HIPAA special enrollment rights, do not apply to same-sex spouses

Background - DOMA

- **A number of challenges to DOMA were filed after its enactment**
- **In 2011, US Attorney General announced that President Obama determined Section 3 of DOMA as applied to same-sex couples legally married under State law violates the Equal Protection component of 5th Amendment of the US Constitution**
  - Accordingly, Department of Justice would no longer defend DOMA

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US v. Windsor - "Down Goes [Section 3 of DOMA]"

- In 2007, Edith Windsor and Thea Spyer, both NY residents, married in Ontario, Canada, and NY recognized the marriage as legal
- When Spyer died in 2009 and left her estate to Windsor; Windsor claimed the surviving spouse estate tax exemption
- Exemption was denied by IRS due to Section 3 of DOMA
- Windsor paid the estate tax without the exemption and then sought a refund, arguing **Section 3** of DOMA was unconstitutional
- Both the US District Court and 2nd Circuit agreed

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US v. Windsor - "Down Goes [Section 3 of DOMA]"

- In a 5-4 decision, issued June 26, 2013, the US Supreme Court held that **Section 3** of DOMA is unconstitutional because same-sex couples in States that recognize same-sex marriage are deprived of the rights afforded to opposite-sex couples in those States
  - Court's opinion is limited to States where same-sex marriages are "lawful"
  - **Section 2** of DOMA was not before the Court and continues in effect
- The result is that in the *13 States and DC that recognized same-sex marriage at that time*, a same-sex spouse is a "spouse" for Federal law purposes, including the Code and ERISA

Same-Sex Marriage/Domestic Partner States

- **Currently, 17 States and DC recognize same-sex marriage:**

California	Connecticut
Delaware	Hawaii
Illinois	Iowa
Maine	Maryland
Massachusetts	New Hampshire
New Jersey	New Mexico
New York	Rhode Island
Vermont	Washington
District of Columbia	

- Federal district courts ruled same-sex marriage bans in Utah (December 20, 2013) and Oklahoma (January 14, 2014) are unconstitutional; both decisions are stayed pending appeal by the states

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Post-*Windsor* Uncertainty

- ***Windsor*** **left unanswered questions in the employee benefits area**
- **In States that recognize same-sex marriage, same-sex spouse is a spouse for both Code and ERISA purposes (along with all other Federal laws)**
- **In States that do not recognize same-sex marriage, it was not clear**
  - *Windsor* limited to States that recognize same-sex marriages
  - **Section 2** of DOMA is still the law
  - Uncertainty for multi-state employers, do they have to recognize same-sex marriages from other states?

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Post-*Windsor* Uncertainty - Retroactivity

- **Since Section 3 of DOMA was found unconstitutional, the law never was and same-sex spouses should have been treated as spouses at all times since marriage was recognized by the State and thus applies retroactively**
  - If same-sex spouse was not given pre-retirement surviving spouse benefits or benefit was paid to non-spouse without the same-sex spouse's consent, does the same-sex spouse have a right of action against the plan?
  - What if 401(k) plan paid death benefit to parents rather than same-sex spouse?
  - What if the couple divorced and plan refused a QDRO?

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DOL Guidance Adds to the Confusion

- **DOL Fact Sheet #28F (August 2013) relies on residency rule:**
  - Spouse means a husband or wife as defined or recognized under state law for purposes of marriage in the state where the employee resides, including "common law" marriage and same-sex marriage
- **Technical Release No. 2013-04 (September 2013) updates guidance to rely on state of celebration rule:**
  - Spouse" will be read to refer to any individuals who are lawfully married under any state law, including individuals married to a person of the same sex who were legally married in a state that recognizes such marriages, but who are domiciled in a state that does not recognize such marriage

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Initial IRS Guidance: Revenue Ruling 2013-17

- **IRS adopts the state of celebration rule:**
  - Same-sex couples, legally married in jurisdictions that recognize their marriages, will be treated as married for federal tax purposes regardless of state where couple resides
  - The ruling does not apply to registered domestic partnerships, civil unions or similar formal relationships recognized under State law
  - Taxpayers may rely (subject to statute of limitations) on the ruling *retroactively* with respect to refunds of employment and income taxes with respect to health and fringe benefits
  - May permit same-sex spouse health benefits to be purchased on pre-tax basis
- **Ruling will be applied prospectively as of September 16, 2013**
- **Also issued two sets of FAQs - one for same-sex marriage and one for domestic partnerships and civil unions**

IRS Guidance: Same-Sex Marriage FAQs

- **Q&As12, 13 & 14 If employee had value of employer-provided health coverage provided to same-sex spouse included as taxable income and/or paid after-tax premiums for such coverage, if statute of limitations is open:**
  - Employer ***may*** claim refund of, or make an adjustment for, any excess social security taxes and Medicare taxes paid (more guidance forthcoming)
  - Employer **may** claim refund for employer portion paid for former employees if reasonable attempts taken to locate them
  - Employer ***may not*** file **c**laim for refunds of overwithheld income tax from employee for prior years (but employee may file refund for prior years)

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IRS Guidance: Same-Sex Marriage FAQs

- **Q&A16 Qualified retirement plans are required to comply with the following rules pursuant to Rev. Rul. 2013-17:**
  - Must treat same-sex spouse as spouse for purposes of satisfying the federal tax laws relating to qualified retirement plans
  - Must recognize a same-sex marriage validly entered into in jurisdiction whose laws authorize the marriage, even if couple lives in domestic or foreign jurisdiction that does not recognize same-sex marriages
  - Rules do not apply to a domestic partnership or civil union, regardless of whether that person's partner is of the opposite or same sex

IRS Guidance – Round Two

- **Notice 2014-51 (September 23, 2013) provides guidance to employers and employees to make claims for refunds or adjustments of overpayments of FICA taxes and income tax withholding for benefits provided to same-sex spouses.**
- **Also provides an optional special administrative procedure for employers to correct overpayments of employment taxes for 2013 and earlier years resulting from retroactive application of Rev. Rul. 2013-17**

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IRS Guidance Round Three - Notice 2014-1

- **May allow employees to change cafeteria plan elections for marriage to a same-sex spouse**
  - Transition relief granted for existing same sex-spouses to allow election changes for plan years that include June 26, 2013 or December 16, 2013
  - Clarify that cafeteria plans that allowed election changes due to a significant cost change in order to enroll a same-sex spouse are protected from June 26 to December 16, 2013
- **Once employer receives notice (through an election change or Form W-4) of marriage must allow pre-tax purchase of same-sex partner health coverage**
  - Clarifies participant may file claim for refund of federal income and employment taxes previously paid on 2013 income tax return

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IRS Guidance Round Three - Notice 2014-1

- **May permit same-sex spouse to receive reimbursement for eligible expenses under health, dependent care or adoption assistance flexible spending account that were incurred during the cafeteria plan year that includes the date of the *Windsor* decision or the date of marriage if later**
- **Confirm same-sex married couples are subject to join deduction limits for contributions to a health savings account**
  - Any excess should be distributed from one or both of the spouse's HSAs by the due date for filing their 2013 tax return (including extensions)
- **Provides a grace period for amending plans until the last day of the first plan year beginning on or after December 16, 2013 (the effective date of the notice).**
  - The cafeteria plan must operate in accordance with the guidance pending such amendment

401(k) and Defined Benefit Plans Post-*Windsor*

- **Qualification issue: Must treat same-sex spouse as spouse regardless of treatment by state of residence**
- **Code uses term "spouse" in number of areas for 401(k) and defined benefit plans**
  - QJSA, QOSA and QPSA - related to spousal benefits
  - Spousal consent - non-spouse beneficiary and optional forms of benefits, which can include loans
  - Code Section 401(a)(9) - required minimum distributions
  - Code 401(k) - hardship withdrawals
  - Code Section 402 rollovers - special rules for spouse
  - Code Section 414(p) - QDROs

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401(k) and Defined Benefit Plans Post-*Windsor*

- **Remember a domestic partner or individual in civil union is not a spouse for qualified plan purpose**
- **Note that while IRS will apply Rev Rul. 2013-17 prospectively as of September 16, 2013 for qualification purposes, IRS treatment will not prevent private litigant suits against plans and plan administrators under retroactivity argument**

Health and Welfare Benefits Post-*Windsor*

- **May be different result depending on whether insured or self-insured welfare plan**
- **If in state that recognizes same-sex spouse, should treat as spouse for insured plans**
- **If self-insured plan, arguably under ERISA preemption, plan could exclude same-sex spouse from coverage in same-sex state**
  - But will this run afoul of state (to extent not preempted) and/or federal nondiscrimination laws?
  - What about employee relations issue if carve out same-sex spouses?

Health and Welfare Benefits Post-*Windsor*

- **Same-sex spouse is eligible for favorable spouse tax treatment regardless of state of residence including:**
  - Code Sections 105 and 106
    - Employer-provided medical benefits under the employer's plan and the portion of plan premiums paid by the employer are not taxable if provided to employees (and retirees), ***spouses*** and dependents
  - Code Section 125
    - Employee contributions to 125 plan for health benefits are pre-tax to the extent used to provide health coverage for the employee, ***spouse*** and dependents
    - Can add a spouse to a 125 plan under change in status rules and may rely on transition relief under Notice 2014-1 for prior additions

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Health and Welfare Benefits Post-*Windsor*

- **For domestic partner or individual in civil union, must qualify as "dependent" under Section 152, otherwise:**
  - "Fair market value" of partner's welfare benefit is imputed income to employee on Form W-2 to extent employee does not purchase such benefit on an after-tax basis
    - Based on cost of coverage the spouse would have to pay in the insurance market, although IRS informally indicated the COBRA cost could be used
  - Cannot be in health reimbursement account or eligible for expense reimbursement through health, dependent care or adoption assistance flexible spending account
  - Group life, AD&D other insured policies may or may not cover the individual
  - VEBAs may only provide a *de minimus* amount of benefits on an after-tax basis or risk loss of tax-exempt status

The Big Question – State Tax Treatment

- **What is state tax treatment of a same-sex married couple's benefits, particularly in those states that follow the Code (i.e., compute state taxes based on the federal definition of adjusted gross income or federal table income) but also have a constitutional amendment prohibiting same-sex marriage?**
  - The answer will depend on how the state defines income for income tax purposes
- **Many states have not addressed this issue and instead have simply issued guidance as to whether a same-sex married couple may file a joint state income tax return, or instead must file separate returns.**
  - *Whether the same-sex couple must file jointly or separately does not provide a definitive answer to employers as to whether same- sex benefits may be provided on a pre-tax basis for state law purposes.*
  - However, because most of these states do not permit the filing of joint tax returns by same-sex spouses, it may be reasonable for employers to assume that benefits cannot be provided on a pre-tax basis and leave it to the employee to sort out the ability to obtain an exclusion on his or her own state tax return

The Big Question – State Tax Treatment

State Position	State Imputed Income Applies?	States
States that recognize same sex marriages.	No	California, Connecticut, Delaware, Hawaii, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New Jersey, New Mexico New York, Rhode Island, Vermont, Washington, District of Columbia
States with no income tax.	No	Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming
States that do not tax health benefits.	No	New Hampshire, Tennessee
States that recognize same sex marriages from other states as civil unions.	No	Colorado, Illinois
States that ban same sex marriage and recognition of same sex marriage from other states.	Yes	Alabama, Arkansas, Mississippi
States that ban same sex marriage and rely on federal income tax system.	Yes	Nebraska, North Dakota, North Carolina, South Carolina, Arizona, Georgia, Idaho, Kansas, Kentucky, Louisiana, Montana, Ohio, Oklahoma, Virginia, West Virginia, Wisconsin
States where tax officials respond that you should not impute income or pay withholding tax on the value of health benefits provided to legal same sex spouses.	No	Indiana, Michigan, Utah
States that advise no imputed income or withholding as long as the premiums are paid through a cafeteria plan.	No	Pennsylvania
States where the state website indicates that it is recognizing same sex marriages from other states.	No	Oregon
States where guidance was issued stating that joint filings will be allowed due to its reliance on the federal system.	No	Missouri

Executive/Equity Benefits Post-*Windsor*

- **Executive benefits/equity awards may be impacted by same-sex marriage issues**
  - Death benefits
  - Domestic relation orders
  - Spousal consent, if required
  - Code Section 132 fringe benefits
- **May be more state law issue than federal law issue**
  - Issues: How is "spouse" defined? What law governs?
  - Note, in states that recognize same-sex marriage term "lawful spouse" should include a same-sex spouse

Post-*Windsor* Litigation

- ***Cozen O'Conner v Tobits* (E.D. PA. July 29, 2013)**
  - Chicago couple Sarah Farley and Jean Tobits married in Canada and Farley later died. Tobits claimed surviving spouse death benefit under ERISA profit sharing plan. Farley's parents claimed they get death benefit as Tobits was not Farley's spouse for Federal law purposes
  - Plan defined spouse merely as person to whom married for one year before death (and thus undefined)
  - Court rules Tobits is spouse and gets death benefit, finding Illinois, while not issuing same-sex marriage licenses, recognizes same-sex marriage based on its civil union statute and thus a "lawful" Illinois marriage
  - Note, on November 20, 2013 Illinois became the 16th state to legalize same-sex marriage

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Post-*Windsor* Litigation

- ***Obergefell v. Kasich* (S.D. Ohio July 22, 2013)**
  - Ohio trial court issued preliminary injunction ordering registrar not to accept death certificate without "married" status and "surviving spouse"
  - Although Ohio has a constitutional amendment banning same-sex marriage, Ohio has always recognized out of states marriages
  - Court states that singling out same-sex marriages as only out of state marriages not recognized is likely a violation of the Equal Protection clause of the Constitution

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Post-*Windsor* Litigation

- **Number of Other *post-Windsor* cases challenging Section 2 of DOMA and state-level marriage bans**
  - Cases have been filed in several non-recognition states arguing unconstitutional for states to not recognize (and in some cases celebrate) same-sex marriages celebrated in other states

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Post-*Windsor* Litigation

- Texas Supreme Court set to hear consolidated cases in November on whether Texas courts can hear divorce petitions of same-sex couples married in other jurisdictions
  - Section 6.204(c) of Texas Family Code provides State may not "give effect to" (1) public acts or judicial proceedings recognizing or validating same-sex marriages or (2) right or claim to legal protections or benefits as a result of a same-sex marriage
  - Couples make jurisdictional and constitutional (Equal Protection, Full Faith and Credit, right to travel, etc.) arguments
  - State claims courts have no jurisdiction to hear same-sex divorce proceedings or grant same-sex divorce as that would require courts to give effect to the same-sex marriage in violation of Section 6.204(c)

What To Do Now

- **Inventory and review all benefit plans and arrangements**:
  - Review "spouse" definition in plan documents and SPDs and other employee communications
  - Review beneficiary designations
  - Review executive/equity and welfare plans' choice of law and determine impact
  - Review tax section descriptions in open enrollment materials, SPDs, S-8s, etc.
  - Review administrative services agreements, requirements documents and other "behind the screen" documents used to operate the plans
  - Determine where amendments may be needed
  - Prepare to discuss impact with management and recommendations/proposals
  - Discuss with insurance companies and TPAs impact and determine what changes may be needed

What To Do Now

- **Determine applicability of Windsor to company leave policies, such as FMLA and USERRA**
  - **Evaluate potential conflicts with state law**
- **Review and update payroll functions**
  - Consider refund claims for open years 2011-2013
  - Refer to Q&As 12, 13 and 14 in IRS's Same-Sex Marriage FAQs regarding refund claims and to Notice 2013-61
- **Monitor guidance issued by IRS and other agencies**
  - Timing of required amendments and potential corrections
  - Potential transition rules, including for 125 plans

What To Do Now

- **Develop plan to address coverage issues by employees under all types of employee benefit plans and policies**
  - For self-insured plans, arguably an employer could exclude same-sex spouse from coverage under the ERISA preemption, however, may run afoul of State and/or Federal discrimination laws

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What To Do Now

- **Prepare employee communications to address impact on plans and benefits**
  - Have a consistent message regarding current process to understand impact of *Windsor* and IRS guidance
- **Update beneficiary designation and other election forms**
- **Review whether there may be potential exposure due to retroactivity issue**
- **Should adopt reasonable verification/certification requirements to confirm same-sex marriage for coverage**

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What To Do Now

- **Don't forget domestic partnerships and civil unions**
  - *Windsor* does not apply to domestic partnership or civil unions and IRS confirms not a spouse for purposes of Code or ERISA
  - But remember *Tobits* decision
  - Refer to IRS's domestic partnership/civil union FAQs
- **Does employer want to offer, amend or terminate coverage for domestic partners/civil unions?**
  - If extending benefits, confirm coverage is available for insured products, including "stop loss" policy under self-insured plan
  - Consider impact on any domestic partner "gross up" policy

Questions?

- **IRS Circular 230 Disclaimer: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein**

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A Run Down of the Top 10 International Tax Traps

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The State Bar of Texas
Section of Taxation - Tax Law Survey in a Day
February 28, 2014
Cityplace, Dallas

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- Tax Treaty Permanent Establishment Analysis
- Transfer Pricing

Domestic Tax Planning

- Federal, State, Income and Employment Tax Planning for Businesses and their Owners
- Mergers & Acquisitions
- Estate Tax Planning
- Charitable Contribution Planning

Tax Controversy

- Internal Revenue Service Audits
- Offshore and Domestic Voluntary Disclosures
- Texas Sales Tax Audits

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        - Vice Chair (2013-Present)
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    - International Tax Committee (2012-Present)
        - Chair (2013-Present)
- Houston International Tax Forum (2012-Present)
- Houston Young Lawyers Association (2012-Present)
    - Scouting Committee (2012-Present)

In the News

- "Recent FBAR and FATCA Developments", *Texas Tax Lawyer* (Winter 2013)

Speeches and Presentations

- "Trawling for Taxpayers: An Update on the Tightening Net of FBAR and FATCA Compliance", State Bar of Texas 16th International Tax Symposium (November 7-8, 2013)
- "Practical Tips and Tricks for FBAR Compliance: A Hands-on Guide for Navigating the FBAR Reporting Regime", *Houston International Tax Forum* (March 7, 2013)

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A Rundown of the Top 10 International Tax Traps: A Practical Guide to Troubleshooting International Compliance Issues

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This outline and associated presentation is meant to be a primer on common issues arising from international tax compliance requirements. It is not meant to be exhaustive, but rather hit the some of the biggest areas of tax compliance issues we see with clients. International tax compliance issues are becoming increasingly more common, and with the IRS continuing to tighten its enforcement on international issues, compliance with the law is as important now as ever. This outline's goal is to give you the tools so you know enough to spot these issues when they arise with a client so you can handle them before they end up with a delinquent return or unreported income.

Each of the 10 issues starts with a scenario, which is loosely taken from issues we have encountered with clients.

List of Issues

1. **FBAR Reporting: Options for Resident Non-Filers**
2. **FBAR Reporting: Opting Out of the OVDP**
3. **FBAR Reporting: Signatory Authority**
4. **Reporting Gifts or Bequests from Foreign Persons**
5. **Income Tax Residency Status: When a Non-Resident Becomes a Resident under the Substantial Presence Test**
6. **Income Tax Residency Status: Treaty Tie-Breaks**
7. **Estate Tax Residency Status: When a Non-Resident Becomes a Resident**
8. **Form 5471 Reporting**
9. **Unreported Interest on Related Party Loans**
10. **Withholding on Payments to Foreign Persons**

1. FBAR Reporting: Options for Resident Non-Filers[1]

a. Scenario. A client (dual citizen of the U.S. and a foreign country) spent the last ten years living and working primarily abroad, even though the company she worked for was headquartered in the U.S. At the advice of a bank advisor, the client made a deal with her company to make all of her salary payments to foreign accounts. These accounts are now valued over $10MM and provide over $400,000 per year in interest income and dividends. The client has since moved back to the U.S. but has not closed the accounts. The client hired a CPA firm to file her returns over the last 10 years and timely filed returns and paid U.S. tax due on her salary, but has never reported the foreign interest and dividend income and has never filed an FBAR. She did not disclose the foreign accounts and income to her tax advisor.

b. Issue. The client is a U.S. person with foreign accounts and thus is required to file an annual FBAR to report the accounts. Additionally, since U.S. tax residents are taxed on their worldwide income, the client should have reported the foreign income on her U.S. tax return.

c. Basic Rule[2]. A United States person that has a financial interest in or signature authority over foreign financial accounts must file an FBAR if the aggregate value of the foreign financial accounts exceeds $10,000 at any time during the calendar year.

d. U.S. Person. United States person means United States citizens; United States residents; entities, including but not limited to, corporations, partnerships, or limited liability companies created or organized in the United States or under the laws of the United States; and trusts or estates formed under the laws of the United States.

e. Financial Interest. A United States person has a financial interest in a foreign financial account for which:

   i. the United States person is the owner of record or holder of legal title, regardless of whether the account is maintained for the benefit of the United States person or for the benefit of another person; or

   ii. the owner of record or holder of legal title is one of the following:

      1. An agent, nominee, attorney, or a person acting in some other capacity on behalf of the United States person with respect to the account;
      2. A corporation in which the United States person owns directly or indirectly: (i) more than 50 percent of the total value of shares of stock or (ii) more than 50 percent of the voting power of all shares of stock;
      3. A partnership in which the United States person owns directly or indirectly: (i) an interest in more than 50 percent of the partnership's profits (e.g., distributive share of partnership income taking into

[1] Note, there is are streamlined procedures available for non-resident non-filers with low amounts of tax due on unreported income. More information can be found here: http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers

[2] See FBAR Instructions.

account any special allocation agreement) or (ii) an interest in more than 50 percent of the partnership capital;

4. A trust of which the United States person: (i) is the trust grantor and (ii) has an ownership interest in the trust for United States federal tax purposes. See 26 U.S.C. sections 671-679 to determine if a grantor has an ownership interest in a trust;
5. A trust in which the United States person has a greater than 50 percent present beneficial interest in the assets or income of the trust for the calendar year; or
6. Any other entity in which the United States person owns directly or indirectly more than 50 percent of the voting power, total value of equity interest or assets, or interest in profits.

f. Foreign Financial Account. A foreign financial account is a financial account located outside of the United States. For example, an account maintained with a branch of a United States bank that is physically located outside of the United States is a foreign financial account. An account maintained with a branch of a foreign bank that is physically located in the United States is not a foreign financial account.

g. Options for Non-Filers

i. Do Nothing

If the IRS investigates and finds a non-filer, it can assert the following civil and criminal penalties, including the possibility of jail time:

1. Civil Penalties: Willful violations are assessed at the greater of $100,000 or 50% of the total balance of the foreign account for every year an FBAR was not filed[3]. This can result in a penalty many times greater than the account balance. For example, if a taxpayer sold his company overseas and held $2,000,000, the entire proceeds of the sale, in the account even just for a week, the penalty for the year could be $1,000,000, even if the account has a zero balance at the end of the year.
2. Criminal Penalties: The IRS can recommend prosecution under several criminal statutes including tax evasion, filing a false return, failure to file an income tax return, and willfully failing to file an FBAR, which would result in additional financial penalties and or jail time.

ii. File all Delinquent FBARs in a Quiet Disclosure if No Unreported Income

The IRS has released a FAQ relating to voluntary disclosures of unreported foreign income. The IRS has provided guidance for taxpayers that did not file FBARs but had no unreported foreign income. For those taxpayers who

[3] 31 U.S.C. § 5321(a)(5)

reported, and paid tax on, all their taxable income for prior years but did not file FBARs, the taxpayer should file delinquent FBARs according to the FBAR instructions and include a statement explaining why the FBARs are filed late[4]. The IRS will not impose a penalty for the failure to file the delinquent FBARs if there are no underreported tax liabilities and you have not previously been contacted regarding an income tax examination or a request for delinquent returns.

iii. File all Delinquent FBARs in a "Noisy" Disclosure

Many tax professionals are advising their clients with some unreported foreign income to follow a procedure similar to FAQ 17, and file amended returns, FBARs, a check for past due tax, standard penalties and interest and a statement explaining the reason for non-filing.

It is important to note that if the Taxpayer has any unreported foreign income or any unpaid U.S. tax, the IRS can assert the same penalties on delinquent filers filing this type of noisy disclosure as non-filers. If you have even one dollar of unreported interest or other income from a foreign account, the IRS could penalize you with the penalties described above on your delinquent FBARs.

iv. Enter the Offshore Voluntary Disclosure Program

The IRS has created a voluntary disclosure program for non-filers to disclose their previously unreported foreign accounts, foreign income, and unpaid U.S. tax. The program provides for significantly reduced civil penalties and no criminal prosecution for taxpayers that come to the IRS before the Justice Department initiates an investigation. To participate in the program, a taxpayer must submit FBARs and amended returns for the prior eight years showing previously unreported income and foreign accounts. The taxpayer will also have to pay the following:

1. Tax on unreported foreign income;
2. Standard statutory 20% accuracy penalty on unreported foreign income;
3. Interest on unpaid tax and penalties; and
4. Offshore Penalty – Instead of the severe civil penalties for non-filers, the Program asserts a 27.5% penalty on the highest value of all foreign assets with associated unreported income. For example, a foreign apartment with unreported rental income would be included in the penalty calculation. This penalty is only asserted once even if the failure to file FBARs was for multiple years.

v. Conclusion. This fact pattern is a prime example of an excellent candidate for

[4] 2012 OVDP FAQ #17

the OVDP. The client worked with a foreign tax advisor to help shield foreign income. There is a significant amount of unreported income and high account balances. The client should enter into the OVDP to ensure lower civil penalties and no criminal exposure.

2. FBAR Reporting: Opting-Out of the OVDP

a. Scenario. A client used another professional help him enter into the OVDP. The client had only $75 per year of unreported foreign income on interest on a modest sized bank account that contained the client's inheritance from a foreign parent. The standard penalty calculation resulted in a $50,000 penalty. The client has no come to you to ask if there are any options other than to pay this penalty.

b. Issue. The client has the option to opt-out of the OVDP and, instead of the standard penalty, face a normal civil examination and statutory FBAR penalties.

c. Basic Rule. The IRS offers taxpayers the right at any time to opt-out of the standard 27.5% penalty and face a normal audit and statuary FBAR penalties. Taxpayers that opt out of the standard penalty:
   1. Will not face criminal prosecution just like in the OVDP;
   2. Will only owe tax, interest, and standard return penalties on the statuary statute of limitation rules instead of the prior eight years; and
   3. Can receive a reduced FBAR penalty or no FBAR penalty if reasonable cause can be shown for the failure to file the FBAR.

d. Types of Penalties. Upon opting out of the OVDP, the taxpayer will face a normal civil examination. At the conclusion of the examination, the taxpayer will face one of three types of penalties: (1) Willful FBAR Penalty, (2) Non-Willful FBAR Penalty, or (3) No Penalty (Warning letter). Note, unlike the OVDP standard penalty, the IRS agent has discretion to adjust the amount of the penalty, subject to guidelines for each type of penalty.

e. Willful FBAR Penalty. For violations occurring prior to October 23, 2004, a penalty up to the greater of $25,000 or the amount in the account (up to $100,000) may be asserted for willfully violating the FBAR requirements[5]. For violations occurring after October 22, 2004, a willfulness penalty may be imposed up to the greater of $100,000 or 50% of the amount in the account at the time of the violation[6].
   i. The test for willfulness is whether there was a voluntary, intentional violation of a known legal duty.
   ii. A finding of willfulness under the BSA must be supported by evidence of willfulness.
   iii. The burden of establishing willfulness is on the Service.

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[5] 31 U.S.C. § 5321 (a)(5).
[6] *Id.*

iv. If it is determined that the violation was due to reasonable cause, the willfulness penalty should not be asserted.
v. Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements. In the FBAR situation, the only thing that a person need know is that he has a reporting requirement. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR.
vi. Under the concept of "willful blindness", willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements.
    1. An example that might involve willful blindness would be a person who admits knowledge of and fails to answer a question concerning signature authority at foreign banks on Schedule B of his income tax return. This section of the return refers taxpayers to the instructions for Schedule B that provide further guidance on their responsibilities for reporting foreign bank accounts and discusses the duty to file Form 90-22.1. These resources indicate that the person could have learned of the filing and recordkeeping requirements quite easily. It is reasonable to assume that a person who has foreign bank accounts should read the information specified by the government in tax forms. The failure to follow-up on this knowledge and learn of the further reporting requirement as suggested on Schedule B may provide some evidence of willful blindness on the part of the person. For example, the failure to learn of the filing requirements coupled with other factors, such as the efforts taken to conceal the existence of the accounts and the amounts involved may lead to a conclusion that the violation was due to willful blindness. The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness.
vii. Willfulness can rarely be proven by direct evidence, since it is a state of mind. It is usually established by drawing a reasonable inference from the available facts. The government may base a determination of willfulness in the failure to file the FBAR on inference from conduct meant to conceal sources of income or other financial information. For FBAR purposes, this could include concealing signature authority, interests in various transactions, and interests in entities transferring cash to foreign banks.

f. Non-Willful FBAR Penalty. For violations occurring after October 22, 2004, a penalty, not to exceed $10,000, may be imposed on any person who violates or causes any violation of the FBAR filing and recordkeeping requirements in a manner that is not considered to be willful. The penalty should not be imposed if the violation was due to reasonable cause.

g. Reasonable Cause Exception to Non-Willful Penalty. If the taxpayer can establish reasonable cause, no FBAR penalty will be issued. Reasonable cause is a facts and

circumstances test. Among the facts and circumstances that will be considered in determining whether reasonable cause exists are:

i. The taxpayer's education;
ii. Whether the taxpayer has previously been subject to the tax;
iii. Whether the taxpayer has been penalized before;
iv. Whether there were recent changes in the tax forms or law that the taxpayer could not reasonably be expected to know;
v. The level of complexity of a tax or compliance issue;
vi. Reliance upon the advice of a professional tax advisor who was informed of the existence of the foreign financial account;
vii. Evidence that the foreign account was established for a legitimate purpose;
viii. Evidence that there was no effort to intentionally conceal the reporting of income or assets; and
ix. Evidence that there was no tax deficiency related to the unreported account.

h. Conclusion. Considering the very small amount of tax due, moderate size of the bank account, and other facts showing that the client is not intentionally hiding income overseas, opting out offers an attractive option to receive potentially receive a lower penalty than the one assessed in the OVDP.

3. FBAR Reporting Example: Signatory Authority

a. Scenario. A client, who is a U.S. citizen residing in the U.S., has a parent who is a citizen of a foreign country that becomes severely ill. The client is given power of attorney for the parent. The parent has several foreign bank accounts. The client has no personal foreign accounts, assets, or businesses. The client has never filed an FBAR.

b. Issue. The client is a U.S. person with signatory authority over a foreign account and thus must file an FBAR in any year in which they retain the power of attorney over the account.

c. Basic Rule. As described in Issue 1 above, U.S. persons with signatory authority or a financial interest in a foreign account must report the account on an annual FBAR. A power of attorney would count as signatory authority.

d. Conclusion. This is a classic example we often see that would fall into 2012 OVDP FAQ 17 with no unreported foreign income. The taxpayer should file delinquent FBARs according to the FBAR instructions and include a statement explaining why the FBARs are filed late. The taxpayer will not face any FBAR penalties for the failure to file FBARs.

4. Reporting Gifts or Bequests from Foreign Persons

a. Scenario. A client, who is a U.S. citizen living in the U.S., has a distant foreign family member from Taiwan that recently passed away. The client will receive a sizable gift from the family member's estate.

b. Issue. Although there is no tax due on gifts or bequests from foreign persons, depending on the size of the gift or bequest, the U.S. person may have a reporting requirement.

c. Reporting Requirement.
   i. Basic Rule. A U.S. person must report on Form 3520 any gift from a foreign person if:
      1. The gift or bequest is valued at more than $100,000 from a nonresident alien individual or foreign estate (including foreign persons related to that nonresident alien individual or foreign estate); or

      2. The gift is valued at more than $13,258 (adjusted annually for inflation[7]) from foreign corporations or foreign partnerships (including foreign persons related to the foreign corporations or foreign partnerships).

   ii. Aggregation of Gifts. You must aggregate gifts received from related parties. For example, if you receive $60,000 from nonresident alien A and $50,000 from nonresident alien B, and you know or have reason to know they are related, you must report the gifts because the total is more than $100,000. Report them in Part IV of Form 3520. Treat gifts from foreign trusts as trust distributions you report in Part III of Form 3520.

   iii. Trap - Reclassification as Income. Make sure this is actually a gift. The IRS may re-characterize purported gifts from foreign partnerships or foreign corporations as items of income that must be included in gross income. Just like with domestic corporations, expect the IRS to closely scrutinize whether the foreign corporation or partnership actually gave this as a gift or is merely allowing the U.S. citizen to avoid recognition of income, particularly in related party situations

d. Filing Deadline. File Form 3520 separately from your income tax return. The due date for filing Form 3520 is the same as the due date for filing your annual income tax return, including extensions. You file an annual Form 3520 for all reportable foreign gifts and bequests you receive during the taxable year.

e. Penalties. A U.S. person who fails to make the required report within the prescribed time, including extensions, is subject to a penalty of 5% of the amount of the gift for each month that the failure continues, up to a maximum penalty of 25%. The penalty

[7] The inflation adjusted amount for 2014 is $14,000.

must be paid on notice and demand by IRS in the same manner as tax[8].

f. Other Issues to Consider. Is the asset a U.S. or foreign asset? For example, if the gift was 100% of the stock of a foreign corporation, valued at $500,000, the taxpayer would have to file the following:
   i. Form 5471 to report the Foreign Corporation;
   ii. Form 8938 to report the Foreign Corporation; and
   iii. If the Client and the Foreign Corporation has foreign bank accounts that aggregate over $10,000, the client will have to file an FBAR to report the corporation's accounts starting in the year he received the corporation's stock.

5. Income Tax Residency Status: When a Non-Resident Becomes a Resident under the Substantial Presence Test.

a. Scenario. Client is citizen of a foreign country and a U.S. E-2 visa holder. Client was present in the U.S. for 100 days in the prior two years and is planning on staying in the U.S. for 150 days in the current year.

b. Issue. Under the substantial presence test, Client will be considered a U.S. tax resident for the current year and be subject to U.S. tax on his worldwide income.

c. Residency Tests. The rules for income tax residency are found in I.R.C. § 7701(b). Under these rules, any alien (non U.S. citizen) who is not considered a resident alien is a non-resident alien. An alien is considered a resident alien if the alien meets one of the three tests:
   i. Green Card Test - Admitted to the U.S., or changing status to, a Lawful Permanent Resident under the immigration laws[9];
   ii. Substantial Presence Test - Meeting the substantial presence test based on number of days in the U.S[10]: or
   iii. First-Year Choice - Making what is called the "First-Year Choice" (a numerical formula under which an alien may pass the Substantial Presence Test one year earlier than under the normal rules)[11].

d. Substantial Presence Test Formula – To meet the substantial presence test, an alien must be physically present in the United States on at least:
   i. 31 days during the current year, and
   ii. 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
      1. All the days you were present in the current year, and
      2. 1/3 of the days you were present in the first year before the current year, and
      3. 1/6 of the days you were present in the second year before the current

[8] I.R.C. § 6039F.
[9] I.R.C. §7701(b)(1)(A)(i).
[10] I.R.C. §7701(b)(1)(A)(ii).
[11] I.R.C. §7701(b)(1)(A)(iii).

year.

e. Conclusion: Dealing with the Residency Issue. If the client being considered a U.S. resident for income tax treatment results in an unfavorable tax income, as it usually does, there are two options for the client:
    i. Stay few enough days to not meet the substantial presence test. Since the client stayed 100 days each over the last two years, he will need to stay 132 days of less this year to not meet the substantial presence test.
    ii. Qualify as a non-resident under a tax treaty between the U.S. and the client's country of citizenship (See next issue).

6. Income Tax Residency Status: Treaty Tie-Breaks

a. Situation. Client is citizen of a foreign country and a U.S. E-2 visa holder. Client was present in the U.S. for 100 days in the prior two years and has already stayed in the United States 190 days this year.

b. Issue. The client has already met the substantial presence test for the year and will be considered a U.S. resident for income tax purposes.

c. Tax Treaty Analysis. The U.S. has entered into double taxation treaties with over 65 countries.[12] Under these treaties, residents of foreign countries are taxed at a reduced rate, or are exempt from U.S. taxes on certain items of income they receive from sources within the United States. These reduced rates and exemptions vary among countries and specific items of income.

   Many times a person will be considered a resident of two different countries under each country's tax laws. In order to avoid double-taxation, the tax treaties provide a set of rules that determines the person to be a resident of only one of the countries, overriding the tax law tests. For example, a Mexican citizen who meets the Mexican definition of residency, and is also a U.S. visa holder that meets the substantial presence test, could "treaty tie-break" under the U.S.- Mexico tax treaty and be considered a resident for Mexican tax purposes and a non-resident for U.S. Income tax purposes.

d. Residency Tie-Breaker Rules. Most of the treaties have a similar article for residency tie breakers. The following article is from the U.S. Mexico Tax Treaty. Article 4 of the treaty provides the residency tie breaker rules:

ARTICLE 4
Residence

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein

[12] http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z

by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of a similar nature. However, this term does not include any person who is liable to tax in that State in respect only of income from sources in that State.

2. Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his residence shall be determined as follows:

a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both Contracting States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);

b) if the State in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;

c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;

d) in any other case, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, such person shall not be treated as a resident of either Contracting State for purposes of this Convention.

e. Residency Tie-Breakers - "Permanent Home" Test. Article 4 gives preference to the country in which the individual has a permanent home available to him. This criterion will frequently be sufficient to solve the conflict, e.g. where the individual has a permanent home in one country and has only made a stay of some length in the other country. The residence is that place where the individual owns or possesses a home; this home must be permanent, that is to say, the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration. As regards the concept of home, it should be observed that any form of home may be taken into account (house or apartment belonging to or rented by the individual, rented furnished room). But the permanence of the home is essential; this means that the individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay which, owing to the reasons for it, is necessarily of short duration (travel for pleasure, business travel, educational travel, attending a course at a school, etc.).

f. Residency Tie-Breakers: "Center of Vital Interest" Test. If the individual has a permanent home in both countries, it is necessary to look at the specific facts in order to determine which of the two countries his "personal and economic relations" are closer. Relevant facts include: family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he

administers his property, etc. The circumstances must be examined as a whole, but it is nevertheless obvious that considerations based on the personal acts of the individual must receive special attention.[13] If a person who has a home in one country sets up a second home in the other country while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his "center of vital interests" in the first State.[14] Some commentaries on the "center of vital interest" test (as it is applied internationally among many income tax treaties) have referred to the foregoing factors, as well as an intention of a person to spend their old age at a certain place, possession of an identity card, membership in a club, the exercise of a hobby, location of person friends, and even the location of family pets.[15]

g. Residency Tie-Breakers: Habitual Abode, Nationality, Mutual Agreement. If the individual has a permanent home in both countries, paragraph 2 of Article 4 gives preference to the country with which the personal and economic relations of the individual are closer: the "center of vital interests". In the cases where residency cannot be determined by reference to this rule, paragraph 2 of Article 4 provides as further criteria each of "habitual abode"[16], and then "nationality". If the individual is a national of both States or of neither of them under the foregoing tests, the question shall be solved by mutual agreement between the States concerned according to the procedure in Article 25.

h. Conclusion – Pay close attention to U.S. immigration status and the number of days stayed in the U.S. Even if the client is considered a U.S. resident for income tax purposes, you may be able to tie-break the client under a treaty to be a non-resident for U.S. income tax purposes.

7. Estate Tax Residency Status: When a Non-Resident Becomes a Resident

a. The Scenario. The client is a citizen of a foreign country on a temporary visa to visit family and suffers a serious medical issue. The client applies for lawful permanent residence (her green card) to allow for continued medical treatment in the U.S.

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[13] Under the U.S. Model Treaty, "'Center of vital interests' considers the individual's family, employment, friends, personal possessions, and other similar criteria." Surviving a Heart Attack: Expatriation and the Tax Policy Implications of the New Exit Tax, Stephen A. Arsenault, 24 Akron Tax J. 37, 40 (2009).

[14] The words "personal and economic relations" were selected to pick up pecuniary and non-pecuniary interests. In the creation of the first model tax treaty by the OEEC (forerunner of the present OECD) in 1963, its drafters chose from among formulations which would have included only the stronger economic relations, only the stronger personal relations, and both economic and personal relations together. See Understanding the OECD Model Tax Convention: The Lesson of History, John F. Avery, 10 Fla. Tax Rev. 1, 18-19 (2009). Advice Memoranda of the IRS have referred to both the OECD model tax treaty and the US Model Treaty in interpreting particular income tax treaties, including for the "permanent home" and "center of vital interests" tests. See, e.g., IRS Memorandum to Charles Prince, May 1 1995, IRS Memorandum to Rosemary Sereti, April 18, 2012.

[15] See, e.g., Klaus Vogel on Double Taxation Conventions, Third Edition, Kluwer Law International 1997; ATO Interpretive Decision (ID 2011/53) (Australia), June 17, 2011.

b. Issue. Depending on a number of facts and circumstances, the client could be considered domiciled in the U.S. and subject to the U.S. estate tax on her worldwide assets upon death.

c. Basic Rule. For purposes of the U.S. estate and gift taxes, an alien is considered a U.S. resident if he or she is domiciled in the U.S. at the time of his or her death or at the time of a gift. If an alien enters the U.S. for even a brief period of time, with no definite present intention of later leaving the U.S., he or she is deemed to be domiciled in the U.S. and, therefore, is considered a U.S. resident for estate and gift tax purposes.[17] Thus, an alien may be considered a nonresident for estate tax purposes and a U.S. resident for income tax purposes, or the opposite, since the estate tax residency test is the more subjective domicile test just described, while the income tax residency test is met if the alien satisfies an objective day count test known as the "substantial presence test" or holds a green card (*i.e.*, is a lawfully admitted permanent resident of the U.S.).[18]

d. Domicile Test. Some of the factors on which the IRS and courts focus[19] are:

i. the length of time spent in the U.S. and abroad and the amount of travel to and from the U.S. and between other countries;[20]
ii. the value, size, and locations of the donor's or decedent's homes and whether he or she owned or rented them;[21]
iii. whether the alien spends time in a locale due to poor health, for pleasure, to avoid political problems in another country, etc.;[22]
iv. the situs of valuable or meaningful tangible personal property;[23]
v. where the alien's close friends and family are situated;[24]
vi. the locales in which the alien has religious and social affiliations or in which he or she partakes in civic affairs;[25]
vii. the locales in which the alien's business interests are situated;[26]
viii. visa status;
ix. the places where the alien states that he or she resides in legal documents;[27]
x. the jurisdiction where the alien is registered to vote;
xi. the jurisdiction that issued the alien's driver's license; and
xii. the alien's Income tax filing status.

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[17] Treas. Reg. §§ 20.0-1(b) and 25.2501-1(b).
[18] *See* Code § 7701(b)(1)(A).
[19] *See* Heimos, 837-2nd T.M., *Non-Citizens – Estate, Gift and Generation-Skipping Taxation*, Part III.C.4
[20] Paquette Est. v. Comr., T.C. Memo. 1983-571.
[21] *See* Fokker Est. v. Comr., 10 T.C. 1225 (1948) and Nienhuys Est. V. Comr., 17 T.C. 1149 (1952).
[22] *Id.*
[23] *See* Farmers' Loan & Trust Co. v. U.S., 60 F.2d 618 (S.D.N.Y. 1932).
[24] *See* Nienhuys.
[25] *See* Farmers' Loan and Nienhuys.
[26] *See* Fokker.
[27] *See* Fokker and Farmers' Loan.

e. Options to Avoid Residency Determination. The client has two options to avoid determination as a U.S. resident for estate tax purposes:
   i. Establish that she is a non U.S. domiciliary based on the factors above.
   ii. Tie-break under a U.S. Estate Tax treaty.

f. U.S. Estate Tax Treaties. The U.S. has estate and gift tax treaties with the following countries: Australia, Austria, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, South Africa, Sweden, Switzerland, and the United Kingdom. Each of these treaties alters in some respect the rules discussed above with respect to the application of the estate and gift taxes to nonresident aliens who reside in these countries. A discussion of treaty tie-breaking is beyond the scope of the article, however the analysis is similar to the treaty tie-breaking in the income tax treaties.

8. Form 5471 Reporting

a. The Scenario. A client, who is a U.S. citizen, wholly owns several foreign corporations and has been timely filing his income tax return and required Form 5471s for the entities. The client acquired a 25% interest in a foreign corporation last year but did not file a Form 5471 for the corporation.

b. Issue. In any year a client owns or acquires an interest in a foreign corporation, the Form 5471 filing requirements should be looked at closely to see if there is a filing requirement. In this case, when a U.S. person acquires a greater than 10% interest in a foreign corporation, the U.S. person must file a Form 5471.

c. Background. Form 5471 is required to be filed by U.S. persons to satisfy reporting requirements under I.R.C. Sections 6046 (acquisitions or dispositions of foreign corporate stock) and 6038 (information reporting in connection with certain foreign corporations). A U.S. person with reporting requirements for more than one foreign corporation must file a Form 5471 for each entity. The type of information required for a filer is based on which of the four categories of filers the filer meets[28]. If a U.S. person falls into multiple categories, the U.S. person must file all of the information required for each of the respective categories.

d. Filing Deadline. Form 5471 is due at the same time as the filing taxpayer's U.S. income tax return, including extensions.

e. Penalties for Non-Filing or Substantially Incomplete Filing. A taxpayer who fails to file a required Form 5471 can be subject to two different types of penalties for non-compliance:
   i. Monetary Penalties – A monetary penalty of up to $10,000 per year, for each

[28] The definition of "U.S. person" is different depending on the category of filers (2, 3, 4 and 5). Note that prior to 2004 there were five categories of filers; however the "Category 1" requirement was repealed in 2004. The other categories of filers have not been renumbered.

foreign corporation[29].

ii. Foreign Tax Credit Reduction – The failure to file may also result in a reduction of foreign tax credits[30].

f. Conclusion. If the taxpayer has no unreported foreign income and only failed to file the information return, the taxpayer should file the delinquent Form 5471, with an amended return with a statement explaining the reason for the late filing[31]. The taxpayer should file the amended return even if there are no changes to report other than the Form 5471.

The IRS will not impose a penalty for the failure to file the delinquent Forms 5471 if there are no underreported tax liabilities and the client has not previously been contacted regarding an income tax examination or a request for delinquent returns[32]. Note, if there is unreported foreign income, the client will be faced with the issues in Issue 1 above and this procedure and availability of no penalties will not be applicable to the client.

9. Unreported Interest on Related Party Loans

a. Scenario. Client is the 100% owner of a U.S. corporation and a foreign corporation. The foreign corporation has made an intercompany loan to the U.S. corporation. Interest has not been paid or accrued on the loan.

b. Issue. Interest must be charged on intercompany loans at rates that would be charged between unrelated parties.

c. Basic Rule. Interest on loans between related parties must be charged at an arm's length rate of interest. Treasury Regulation §1.482-2 states that, for advances or loans between related parties, the IRS may make appropriate allocations to reflect an arm's length rate of interest[33].

d. Safe Harbor. The regulation does provide safe haven rates tied to the applicable federal rate that, if used, would exempt the interest rate from being questioned by the IRS. The safe harbor rates for intercompany loans are between 100% AFR and 130% AFR based on the AFR in the month the loan was created[34]. The AFR to be used depends on the length of loan[35]. There are three lengths of loans, with different

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[29] I.R.C. §6038(b)(1)

[30] I.R.C. §6038(c)(1)

[31] The IRS has released a FAQ relating to voluntary disclosures of unreported foreign income. The FAQ also provides guidance on the late filing of Form 5471s. FAQ 18 of the 2012 OVDP FAQs provides the guidance explained above. The FAQ can be found here: http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers

[32] The client should include at the top of the first page of each information return "OVDI - FAQ #18" to indicate that the returns are being submitted under this procedure.

[33] Treas. Reg. §1.482-2(a)(1)(i)

[34] Treas. Reg. §1.482-2(a)(2)(iii)(B) & (C)

[35] A list of the most current AFR, released by month, can be found here:

interest rates applied to each loan:

i. Short Term – Three years or less
ii. Mid-Term – Three to less than 9 years
iii. Long-Term – More than years

e. No Safe Harbor for Other Currencies. The safe haven interest rates do not apply to any loan or advance that has the principal or interest expressed in a currency other than U.S. dollars[36].

f. Conclusion. The client should determine a safe harbor interest rate to charge retroactively from the beginning of the loan, based on the AFRs from the time the loan was originated.

10. Withholding on Payments to Foreign Persons

a. Scenario. The client runs a consulting business in the U.S. providing advice to customers worldwide. For a particular deal, the client hires an independent contractor who is a non U.S. citizen to come to the client's office in the U.S. for a week to help with a particular project.

b. Issue. The income earned by the independent contractor is U.S. source income (personal services income earned in the U.S.) paid to a foreign person. The client must withhold on the payments to the independent contractor.

c. Basic Rule. Generally, a foreign person is subject to U.S. tax on its U.S. source income. Most types of U.S. source income received by a foreign person are subject to U.S. tax of 30%[37]. A person that makes such a payment is required to withhold on the payment. If they do not withhold, they can personally liable for the tax due.

d. Compliance with Rule. Withholding on a payment of U.S. source income to foreign persons should be made on Form 1042 and related Form 1042-S.

e. Reduction by Treaty. A reduced rate, including exemption, may apply if an Internal Revenue Code Section provides for a lower rate, or there is a tax treaty between the foreign person's country of residence and the United States.

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http://apps.irs.gov/app/picklist/list/federalRates.html
[36]Treas. Reg § 1.482-2(a)(2)(iii)(E).
[37] The withholding rules are found in I.R.C. §1441-1443

Partnership and Limited Liability Companies 101

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BIOGRAPHY

Chester W. Grudzinski, Jr.'s practice centers upon federal, state, and other tax matters relating to various businesses and entities. He has represented many clients with the formation, operation, and liquidation of all types of business entities, including in that process many mergers and acquisitions. Mr. Grudzinski represents individuals, private business interests, and publicly traded companies. He also represents clients in tax controversy matters. His emphasis has been upon partnerships, limited liability companies, S corporations, and trusts that have engaged in a wide range of businesses, including investment activities, real estate activities, oil and gas activities, and other active businesses.

Mr. Grudzinski is a Trustee of the Law School Foundation of Texas Tech School of Law. Mr. Grudzinski is also an active member with the Partnership Tax Committee of the American Bar Association and has participated as a speaker and as a member of discussion panels for such committee. Mr. Grudzinski has a commitment to the community through his service on the Board of the Longhorn Council, Boy Scouts of America, as a Westside Little League baseball coach, and as a volunteer coordinator at the Presbyterian Night Shelter in Fort Worth for All Saints Episcopal Church.

EXPERIENCE AND HIGHLIGHTS

Lead tax counsel in many complex organization and restructuring matters, including:

- Representation of billion dollar investment and hedge fund partnerships in formation, contributions, distributions, and restructurings
- Representation of real estate partnerships in federal tax controversy matters
- Represented a cable company and related entities in a federal tax controversy matter
- Representation of numerous investment and hedge fund partnerships in structuring and negotiating various investments, including equity and credit derivatives
- Representation of many partnerships regarding formation, allocations, and distributions relating to tax exempt and foreign partners
- Represented a local business owner in a dispute with the IRS over a tax shelter
- Representation of many partnerships in the acquisition, restructuring, and disposition of impaired debt

AFFILIATIONS AND HONORS

- Tarrant County Bar Association

- American Bar Association, Partnership Tax Committee
- Certified Public Accountant, Texas, 1983
- Texas Tech Law School Foundation, Trustee
- Boy Scouts of America, Longhorn Council, Vice President of Finance

EDUCATION

- Texas Tech School of Law, J.D., *cum laude*, 1981
- University of Texas at El Paso, B.B.A., with honors, 1978

ADMISSIONS

- State Bar of Texas, 1981
- U.S. Tax Court

SPEECHES & PUBLICATIONS

- "New Medicare Tax Lacks Specificity" *Law360*, November 20, 2013
- "How Carried Interest Legislation Could Change Real Estate Investing," *Journal of Real Estate Taxation*, Volume 39, Number 04, Third Quarter 2012
- Political Activity and 501(c)(4) Organizations, Fort Worth Business Press (June 2013), co-author with Chester Grudzinski."
- Consequences of Acquiring Distressed Real Estate Loans," Real Estate Taxation, 4th Quarter 2009 (WG&L)
- “Federal Income Tax Issues Arising Out of Modifying a Distressed Loan,” speech, October 15, 2009, Texas Bar CLE Advanced Real Estate Strategies Course
- "Allocating Liabilities in Partnerships with Disregarded Entity Partners," speech, June 19, 2007, Fort Worth Chapter of Tarrant County Certified Public Accountants
- "Tax Shelters from the Buyers' Viewpoint," speech, February 3, 2004, Fort Worth Chapter of Tarrant County Certified Public Accountants
- "FLPs after Strangi, Kimbell and Turner," speech, March 3, 2003, Fort Worth Chapter of Tarrant County Certified Public Accountants
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- "Property Contributions to Partnerships More Likely to Result in Gain After TRA 97," Journal of Partnership Taxation, Winter 1999
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- Co-Author: "Restructuring Leveraged Buyouts," The Journal of Corporate Taxation, Winter 1991
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- "Coordinating 303's Redemption Benefits With the Estate Tax Deferral Rules of 6166," Journal of Taxation for Accountants, July 1984

PARTNERSHIP TAXATION

FORMATION, DISTRIBUTIONS & TERMINATION

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PARTNERSHIPS-OVERVIEW

DEFINITION OF PARTNERSHIP. An unincorporated association with two or more persons that has elected, or defaulted to, partnership classification under the Check-the-Box Regulations (Reg. §301.7701-3), which provide that the default classification of an entity is a; (1) partnership if it has 2 or more members and is a (a) domestic eligible entity, or (b) foreign eligible entity that has at least one member with unlimited liability, or (2) a disregarded entity if it has a single member and is a (a) domestic eligible entity or (b) foreign eligible entity where the member has unlimited liability.

An election on Form 8832 will be required for many foreign eligible entities, and is generally required to be filed within 75 days after the effective date. Rev. Proc. 2009-41 provides for an extension of up to 3 years and 75 days as long as all tax reporting has been consistent with the desired classification and “reasonable cause” is shown for the failure to timely file. This late filing is made on Form 8832 with reference to the Rev. Proc. Also see, PLR 200209009 (foreign entity seeking a late election for partnership classification) and PLR 200210003 (foreign entity disregarded classification).

For income tax purposes, partnerships are generally treated as pass-through entities, i.e., the partnership pays no taxes, and partnership income, loss and other items are reported to each partner on a Form 1065K-1. Partners report these items on their own tax returns, even if the partners have not received the cash and do not have access to the cash. Two exceptions to such treatment are (1) publicly traded partnerships (§7704) and (2) taxable mortgage pools (§7701(i)) .

PARTNERSHIPS-OVERVIEW

Code Definition – §761 “The term partnership includes a syndicate group pool, joint venture or other unincorporated organization through or by means of which any business, financial operation or venture is carried on and which not,…a corporation or trust or estate. Under regulations the Secretary may, at the election of all members of an unincorporated organization, exclude the organization from the application of all or part of the partnership rules, if it is availed of—

1. For investment purposes only and not for the active conduct of a business
2. For joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or
3. By dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular line of securities,
4. If the income of the members of the organization maybe adequately determined without the computation of partnership taxable income.

PARTNERSHIPS-OVERVIEW cont'd

Reg. §1.761-2 provides that under the conditions therein certain unincorporated entities may be excluded from the partnership provisions. The first category is an "investment partnership", which requires that the participants own the property as co-owners, reserve the right to take or dispose of their shares of any property, and do not conduct business or authorize someone to act for the group for more than 1 year.

The more common application is an "operating agreement" for the joint production or extraction of minerals, where the participants must –

i. Own the property as co-owners
ii. Reserve the right to take in kind or dispose of their shares of the production and
iii. Do not jointly sell services or delegate authority to sell for more than 1 year

PARTNERSHIPS-OVERVIEW cont'd

Election: §1.761-2(b) requires an election to be excluded, but Reg. §1.761-2(b)(2)(ii) deems the election if it can be shown that the members intended to be excluded. This is usually shown by the agreement and the consistent tax reporting by the parties.

No Actual Partnership: A group of co-owners may not form a limited partnership, contribute assets to the partnership, and have the partnership buy and own the assets and deal with the assets, and have the partnership elect to be excluded from being a partnership. In such event the co-owners own interests in the partnership and are not co-owners of the property, and the organization is not eligible for the exclusion. PLR 200305025.

Operating Agreements – Tax Partnerships

When an oil & gas deal includes a carry it is common to have an operating agreement for the economic arrangement with an exhibit that creates a tax partnership. Although this is not an entity for state law purposes this is a partnership for tax purposes. Accordingly, the members own partnership interests not direct mineral interests. The purpose of this partnership is to allow the participants to get the deductions attributable to the relative cash contributions for the deal. Note that this is a partnership interest for sales and transfers including §1031 issues.

TENANTS – IN—COMMON

For certain real estate transactions parties wish to be co-owners but not partners (usually in connection with §1031 exchanges). Rev. Proc. 2002-22 provides guidelines to get a ruling on this matter. These guidelines have been used to draft agreements for transactions involving Tenants in Common (or "TIC") interests.

PARTNERSHIP FORMATION BASICS

1. PROPERTY GENERALLY CONTRIBUTED TAX-FREE §721(a).
2. BASIS GENERALLY CARRIES OVER TO THE PARTNERSHIP plus any (§721(b) gain) §723.
3. PARTNERSHIP'S HOLDING PERIOD INCLUDES CONTRIBUTOR'S §1223
4. BASIS IN PARTNERSHIP INTEREST IS BASIS IN CONTRIBUTED ASSETS (plus §721(b) gain). PLUS SHARE OF LIABILITIES §§722 & 752
5. HOLDING PERIOD FOR PARTNERSHIP – ALL CASH STARTS ON DATE OF CONTRIBUTION. PORTION ATTRIBUTED TO PROPERTY WILL HAVE THE SAME AS THE PROPERTY §1.1223-3.

PARTNERSHIP CONTRIBUTIONS
Overview of §721

No gain or loss. Generally, §721(a) provides that no gain or loss is recognized by the partnership or any of its partners if property is transferred to a partnership in exchange for a partnership interest. It does not matter whether the transfer is at the initial partnership formation or after the partnership had already been formed. Note that there is no control after the transfer requirement like the one for transfers to corporations under §351 contribution.

PARTNERSHIP CONTRIBUTIONS
Overview of §721

What is "property"?

"Property" includes just about everything except services (i.e., cash, inventory, installment obligations, receivables, land, other tangible assets, nonexclusive licenses and industry know-how.)

Exceptions:

Services—Reg. §1.721-1(b)(1).

Partnership unpaid rent & royalties that accrued to the to the transferor.

Partnership unpaid interest (including original issue discount) that accrued while held by the transferor—Reg. §1.721-1(d)(2).

PARTNERSHIPS CONTRIBUTIONS
Contribution of Part Property/Part Services

How does §721 apply if a person contributes both property and services?

The receipt of a partnership interest for services will generally be treated as a separate transaction outside the scope of §721. The transfer of property will be subject to the provisions of §721.

PARTNERSHIP CONTRIBUTIONS
Capital Interest for Services

- A capital interest received for services will be taxable to the recipient.
- Example: Individual provides services to Partnership and as payment for such services receives a partnership interest in capital and profits with a value of $10X. The receipt of the partnership interest is not covered by §721 and is taxable to Individual as ordinary compensation income.
- The 2005 Proposed Regulations (in the preamble, see CCH Vol. 6 at 92,642, Winter 2014) stated that the Treasury and the IRS believe that partnerships should not be required to recognize gain on the transfer of a compensatory partnership interest unless the transfer was in connection with the formation of the partnership (McDougal, 62 TC 720 (1974)). How long do you have to wait?

PARTNERSHIP CONTRIBUTIONS
Profits Interests

- Generally, the receipt of a profits interest is not taxable to the recipient or the partnership. Rev. Proc. 93-27.
- Rev. Proc. 93-27 defined a "capital interest" as "an interest that would give the holder a share of the proceeds if the partnership's assets were sold at fair market value and then the proceeds were distributed in a complete liquidation of the partnership." A profits interest is a partnership interest other than a capital interest.
- The services must be "to or for the benefit of the partnership."
- Rev. Proc. 93-27 does not apply to:
  1. A profits interest that relates to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease.
  2. If within 2 years of receipt, the partner disposes of the profits interest.
  3. If the profits interest is in a publicly traded partnership.

PARTNERSHIP CONTRIBUTIONS
Profits Interests

- Rev. Proc. 2001-43 supplemented Rev. Proc. 93-27 by allowing profits interests subject to vesting to qualify for tax free treatment.
- Rev. Proc. 2001-43 provides that, for purposes of Rev. Proc. 93-27, where a partnership grants an interest in the partnership that is substantially nonvested to a service provider, the service provider will be treated as receiving the interest on the date of grant, provided that:

1. The partnership and the service provider treat the service provider as the owner of the partnership interest from the date of its grant and the service provider takes into account the distributive share of partnership income, gain and loss;
2. Upon the grant of the interest or at the time of vesting, neither the partnership nor any of its partners deducts any amount (e.g., as wages) for the fair market value of the interest; and
3. All other conditions of Rev. Proc. 93-27 are satisfied.

PARTNERSHIP CONTRIBUTIONS
Profits Interests

- Examples:
- Individual receives a profits interest in a partnership for services. The partnership interest represents 20% of the profits. Individual will receive a 5% interest at the beginning of year 1 and will receive an additional 5% interest at the beginning of each of years 2, 3 and 4. The receipt of the initial 5% profits interest will be covered by Rev. Proc. 93-27 (assuming all other requirements are met). The 5% interests received in each of the other 3 years will be subject to additional valuation risks and will not be covered by Rev. Proc. 2001-43.
- Same as prior example except that all 20% is transferred at once and 15% will be subject to a substantial risk of forfeiture that will expire at the rate of 5% per year. Assuming the other issues in Rev. Proc. 2001-43 are met the receipt of this interest is subject to a valuation at the time of receipt, but not at the time each 5% interest vests.

PARTNERSHIP CONTRIBUTIONS
Partnership Debt

- The contribution of a partnership debt in exchange for a partnership interest (capital or profits) is subject to the §721 rules for the contributing partner (including the accrued interest issue), but not for the partnership. Reg. §1.721-1(d)(1) & §108(e)(8)(B).
- Section 108(e)(8)(B) provides that when a partnership transfers a partnership interest to a creditor in satisfaction of a partnership debt, the partnership shall be treated as having satisfied the debt with an amount of money equal to the fair market value of the partnership interest and any excess would be recognized as cancellation of indebtedness income.
- The COD income is allocated to the partners of the partnership immediately prior to the satisfaction of the debt(i.e., no daily allocation is allowed).
- The Section 108(e)(6) exception for using the basis of debt held by a shareholder rather than the value of the stock (here partnership interest) does not apply to partnerships.

PARTNERSHIP CONTRIBUTIONS
Partnership Debt - cont'd

- Regulations allow the use of the liquidation value for the value of the partnership interest. This is the amount of cash the creditor would receive with respect to the interest if, immediately after the transfer, the partnership sold all of its assets (including all intangibles) for cash equal to the fair market value of the partnership's assets and then liquidated. To use this valuation the following must be met:
  1. The creditor, the partnership and all partners must report consistently with such valuation.
  2. All partnership interests issued as part of the same overall transaction must also be consistent.
  3. Must have terms that are comparable to an agreement by unrelated parties negotiating with adverse interests.
  4. No redemption or sale of the partnership interest that is part of a plan at the time of the debt/equity exchange to avoid COD income(creditor can't be a temporary partner).

PARTNERSHIP CONTRIBUTIONS
Investment Partnership

- Section 721(b) provides that §721(a) shall not apply to gain realized on a transfer of property to a partnership that would be an investment company under §351 if it were incorporated.

PARTNERSHIP CONTRIBUTIONS Investment Partnership

- An investment partnership is a partnership with more than 80% of its assets in the form of any combination of the following (Prohibited Assets):
- Cash
- Stocks and other equity interests in a corporation, evidences of indebtedness, options, forward or futures contracts, notional principal contracts and derivatives,
- Any foreign currency,
- Any interest in a real estate investment trust, a common trust fund, a regulated investment company, a publicly traded partnership, or any other equity interest which pursuant to its terms or any other arrangement is readily convertible into or exchangeable for any assets described herein,
- Except to the extent provided in regulations, any interest in precious metal, unless such metal is used or held in the active conduct of a trade or business after the contribution,
- Except as provided in regulations, interests in any entity if substantially all of the assets of such entity consist (directly or indirectly) of any assets described herein, or certain other entity interests or assets to be included in any regulations.

PARTNERSHIP CONTRIBUTIONS
Investment Partnership

- Additional rules:
- With respect to partnership interests if 90% or more of the partnership's assets are Prohibited Assets then the entire interest is treated as a Prohibited Asset, if 20% or more but less than 90% of its assets are Prohibited Assets then a proportionate part of the partnership interest is included as a Prohibited Asset, and if less than 20% of the partnership's assets are Prohibited Assets then the entire interest is not a Prohibited Asset. Legislative History Taxpayer Relief Act of 1997.
- This is a gross assets test, so leverage can be used to buy additional assets.
- If a partnership owns 50% or more of the vote or value of the stock in a corporation then the partnership is treated as owning a pro rata portion of the assets of the corporation. Reg. §1.351-1(c)(4).
- Assets not held for investment are excluded from Prohibited Assets.
- The transfer must result in the direct or indirect diversification of the assets transferred into the partnership. Reg. §1.351-1(c)(1)(i).
- Generally determined immediately after the transfer, but will be delayed for changed circumstances pursuant to a plan in existence at the time of transfer.

PARTNERSHIP CONTRIBUTIONS
Investment Partnership-Diversification

General Rule: A transfer ordinarily results in diversification if two or more persons transfer nonidentical assets to a partnership. Reg. §1.351-1(c)(5).

Insignificant Transfer: If a transaction involves one or more transferors of nonidentical assets that, taken in the aggregate, constitute an insignificant portion of the total assets transferred, such insignificant transfers will be disregarded in determining whether diversification has occurred.

Already Diversified: A transfer of stock and securities will not be treated as resulting in diversification if it is already diversified as defined in §368(a)(2)(F)(ii)—no more than 25% in one issuer or more than 50% in 5 or fewer issuers. Reg. §1.351-1(c)(6).

PARTNERSHIP CONTRIBUTIONS
Investment Partnership-Examples

Example 1: Husband and wife own closely held securities and real estate as separate property. The assets are held for investment. They form partnership by contributing the assets and own the partnership 50/50. The marketable securities represent more than 80% of the value of the partnership's assets. The closely held securities represent more than 25% but less than 50% in each issuer. The transaction is a taxable sale rather than a tax free formation of a partnership. Husband and wife could have split the assets on a 50/50 basis prior to the contribution and could have avoided the taxable event. This would be true even if Husband and Wife intended to make gifts of the partnership interests. PLR 200317011, PLR 9811022.

PARTNERSHIP CONTRIBUTIONS
Investment Partnership-Examples

Example 2: A contributes 100 shares of corporation X to Partnership AB and B contributes 100 shares of corporation Y to Partnership AB. The stock is held for investment. Neither contribution represents more than 50% of the outstanding stock of the applicable corporation and Partnership AB has no other assets. Both contributions are treated as taxable sales.

PARTNERSHIP CONTRIBUTIONS
Investment Partnership-Examples

Example 3: A and B are equal partners in Partnership AB. Partnership AB holds company X stock for investment that is worth $900. Partnership AB has no other assets. The stock is not 50% or more of the outstanding stock of company X. Individual C contributes real property worth $100 to Partnership AB with a basis of zero. The contribution of the real property by C is a taxable transaction.

PARTNERSHIP CONTRIBUTIONS Investment Partnership-Examples

Example 4: Partnership Z is formed with the contribution of a single stock by a number of individuals and a general partner contributing cash equal to 1% of the total assets. Promptly after the contribution the Partnership borrows money and buys additional stock and securities. Diversification has occurred, but not as a result of the contribution to and formation of Z. This is a tax free formation. The 1% of cash is disregarded under the insignificant contribution provision. Reg. §1.351-1(c)(5) & §1.351-1(c)(7), Example 1. PLR 9607005.

PARTNERSHIP CONTRIBUTIONS Disguised Sales – General Rules

What is a disguised sale?

Sec. 707(a)(2)(B) and Reg. §1.707-3 provide that any contribution and distribution of property (other than a capital interest) between partner and partnership within 2 years of each other is presumed to be a disguised sale. The burden is on the taxpayers to prove otherwise. For this purpose certain liabilities may result in a disguised sale. Go to Reg.1.707(3)(e), example 8 for a description of the IRS view regarding a disguised scale for contributions and distributions that are more than 2 years apart.

Exceptions exist for certain guaranteed payments, reasonable preferred returns, cash flow distributions and the distribution of the proceeds of certain liabilities.

PARTNERSHIP CONTRIBUTIONS
Disguised Sales – General Rules

If a contribution of property by a partner to a partnership followed by a distribution by the partnership to the partner is a disguised sale, then it is treated as if the partner sold a fraction of the contributed property to an unrelated 3rd party. The fraction treated as sold is equal to the amount of cash and FMV of property distributed divided by the FMV of the property contributed.

The partnership's basis in the property contributed will be the sum of (1) the FMV of the fraction of the property "sold" to the partnership, plus (2) the basis of the fraction of the property still treated as a contribution.

The partner's basis in the partnership interest will be the basis of the fraction of the property still considered to be contributed, rather than sold.

PARTNERSHIP CONTRIBUTIONS Disguised Sales – General Rules

- A transfers property X to partnership AB. At the time of the transfer property X had a fair market value of $3MM and a basis of $1.2MM. Immediately after the transfer partnership AB transfers $1.2MM of cash to A. Assume that the presumption of a sale applies. A is considered to have sold a portion and contributed a portion of property X. A recognizes gain of $.72MM ($1.2MM realized less basis of $.48MM ($1.2MM/$3MM x $1.2MM)). A has contributed $1.8MM of property X with basis of $.72MM. Reg. §1.707-3(f), example 1.

PARTNERSHIP CONTRIBUTIONS
Liability Shifts– General Rules

- Note that gain is recognized by a partner for excess debt relief (i.e., debt relief – debt assumption – basis in assets contributed).
- Example: A acquired a 20% interest in a partnership for the contribution of property with a value of $10MM, an adjusted basis of $4MM and subject to a mortgage of $6MM. The debt is old and cold, recourse and is assumed by the partnership. The contribution is not otherwise a disguised sale. A has $.8MM of gain calculated as follows:

Debt Relief	$6.0MM
Debt Assumption	($1.2MM)
Adjusted basis in property	($4.0MM)
Net Gain	$0.8MM

PARTNERSHIP CONTRIBUTIONS Special Rules

If a partner contributes unrealized receivables (as defined in §751(c)) to a partnership any gain or loss recognized by the partnership on the disposition shall be ordinary, §724(a).

If a partner contributes inventory any gain or loss recognized by the partnership on the disposition for a 5 year period beginning on the date of the contribution will be ordinary. §724(b).

In the case of any property contributed to a partnership that was a capital asset in the hands of the contributing partner any loss recognized by the partnership for 5 years from the disposition of such asset will be a capital loss to the extent of any built in loss on the date of contribution. §724(c).

PARTNERSHIP CONTRIBUTIONS §2701

- Generally, the subtraction method of §2701 will be applied to determine if there is a taxable gift as a result of any interest (think of common stock) transferred in a family controlled entity to an applicable family member where the senior generation member has an applicable retained interest. To calculate whether there has been a gift (think of preferred stock). Start with the full value of the entity and reduce it by the interest retained by the transferor and the balance will be a gift. Unless the retained interest meets certain rules it will be valued at zero. §2701(a)(3)(A).
- This provision only applies to equity retained by the transferor family member. If debt is issued then that will be subject to the debt Rules (e.g. adequate stated interest, issue price etc.

PARTNERSHIP CONTRIBUTIONS §2701 cont'd

- The other issue in §2701 that causes concern is the minimum value of the interest transferred. If the transaction is subject to the calculation rules of §2701 then the junior equity will be deemed to have a minimum value of 10% of all equity plus debt from the transferor(or an applicable family member).
- To avoid this use debt or make sure all family members have equal slices of each strip of equity. See PLR 200138028 for application of §2701 to a partnership.

PARTNERSHIP CONTRIBUTIONS §2701

Example: If a partnership has $10MM in assets and the senior generation transfers a 20% profits interest to their son that provides the senior generation with all cash until it has received a return of its capital plus a reasonable return rate and then 20% of the profits will go to their son. This would result in a gift of $2MM to their son. Alternatively, if father and son form a partnership by contributing $2MM in cash on a prorata basis (e.g., 80/20) and father lends $8MM and partnerships buys assets for $10MM. Assume the $8MM otherwise qualifies as debt then the transaction will not be subject to §2701 yet it will provide substantially similar economics.

PARTNERSHIP INTEREST HOLDING PERIOD

A partner has a single holding period in an interest in a partnership except as follows:

1. The partner acquired portions of an interest at different times. For example, A and B are equal partners in Partnership Z and have a partnership interest with a value of $1MM and a basis of zero. Each partner has a long term holding period for its partnership interest. On 6/1/14 each partner contributes $1MM cash to Partnership Z. As a result of the contribution, each partner has a new holding period in the portion of the partner's interest that is attributable to the cash contribution made on 6/1/14. The portion is determined by relative values. The portion attributable to the new capital contribution will be 50%. On 1/1/15 A sells his entire interest in Z for $2MM when his basis is $1MM. A recognizes a capital gain of $1MM, and 50% is short term. Reg. §1.1223-3, Ex. 4.

PARTNERSHIP INTEREST HOLDING PERIOD

2. The partner acquired portions of the partnership interest in exchange for property transferred at the same time, but resulting in different holding periods. On 6/1/14 A contributes cash and a nondepreciable capital asset that A has held for more than 1 year to Partnership X for a 50% interest in X. A's interest has a divided holding period with the portion acquired for cash beginning on the date of the contribution and the portion acquired for the property with a holding period of in excess of 1 year. If the cash was $5MM and the property had a value of $5MM then 50% of the interest would start a new holding period and 50% would have a holding period of more than 1 year. If A sells the interest in X on 1/1/15 for $10MM when he has a $5MM basis he will recognize a capital gain of $5MM and half of it will be short term capital gain. Reg. §1.1223-3(f), Ex. 1.

For these purposes if a partner makes contributions and receives distributions during the 1 year period ending on the date of the sale of the partnership interest the partner may reduce capital contributions on a last in first out basis treating all distributions as if they had been received immediately before the sale. Reg. §1.1223-3(b)(2). Separate tracking of the basis and holding period may be available for certain publicly traded partnership interests. Reg. §1.1223-3(c)(2).

Inside Basis Computations

How is a partnership's inside basis in property contributed by partners determined?

Sec. 723 provides that the basis of property received by a partnership will be

- Partner's basis of the contributed property.
- Gain recognized by a partner on contributions of property under §721(b).
- Future adjustments for the activities of the partnership (e.g., depreciation, additions etc.) and adjustments under §754 and §734.

Outside Basis Computations

How is the partner's outside basis in the partnership determined?

Sec. 705 provides rules for determining the basis of a partner's partnership interest:

Increases:

- Basis in contributed property
- Share of partnership taxable income
- Share of tax exempt income
- Excess of the deductions for depletion over the basis of the property subject to depletion

Decreases:

- Share of partnership losses
- Expenditures not deductible and not properly chargeable to a capital account
- Basis of property distributions, including cash
- Depletion for my oil & gas property to the extent such deduction does not exceed the proportionate share of the adjusted basis allocated to such portion under §613A(c)(7)(D).

In addition to the foregoing the basis could go up or down as a result of the death of a partner, and will include liabilities so, increases in liability will increase basis and decreases will decrease basis.

Outside Basis Computations

Special basis rules:

1. Losses may not reduce basis below zero. Instead, they remain suspended until more basis is acquired, for example, through contributions or income.
2. At risk rules have a separate basis calculation and limitation. It may be necessary to have a general basis calculation and an at risk basis calculation.
3. Adjustments are made to basis under §705 and §465 for losses limited by the passive loss rules. Temp. Reg.§1.469-2T(d)(b).

Partnerships—Tax Years

The following rules govern tax years of partnerships:

Majority Interest Taxable Year: Partnerships are generally required to elect the same taxable year as their partners who represent a majority interest (i.e., one or more partners with an aggregate interest in partnership profits and capital of more than 50%)on the first day of the partnership's first tax year. §706(b)(1)(B)(i).

Five Percenters' Common Tax Year. If there is no majority interest taxable year, the partnership must use the same year as that of all of the principal partners, i.e., those owning five percent or more interest in either profits or capital. §706(b)(1)(B)(ii).

Calendar Tax Year. If there is no majority interest tax year and all of the principal partners do not have the same tax year, the partnership generally must use the calendar year. There are two exceptions, (1) the least aggregate deferral rules and (2) the business purpose rules.

Partnerships—Accounting Methods

Cash method. The cash method is available to partnerships that do not have a C corporation partner. The cash method however, may be used by partnerships with C corporation partners if the partnership's average annual gross receipts are $5 million or less in the 3 preceding years (or, if shorter, the period of existence). The determination is made annually. Additionally, the cash method is not available to partnerships that are tax shelters, syndicates under §1256(e)(3)(B) and farming syndicates under §464(c). §448(a). All of these definitions generally apply if more than 35% of the losses are allocated to limited partners that do not actively participate in management.

Accrual Method. Once the three-year (or, if shorter, the period of existence)average annual gross receipts exceeds $5 million, a partnership with a C corporation partner must use the accrual basis thereafter. A tax shelter must also use the accrual method.

Distributions—General Rules §§731-733

What is a distribution?

A distribution is a transfer of value from a partnership to a partner with respect to an interest in the partnership. A distribution may be in the form of money, debt relief (i.e., liability reductions under §752), or other property. Any decrease in a partner's allocable share of partnership debt is treated as a distribution of money. This can result from payment of principal by the partnership on its debt. Also, a draw against a partner's share of partnership income is treated as a distribution made on the last day of the partnership taxable year. Reg. §1.731-1(a)(1)(ii).

Partnership Distributions

Generally tax free to partner and partnership, subject to the following exceptions:

1. If property contributed by one partner is distributed to another partner within 7 years of being contributed then the contributing partner shall be treated as recognizing gain or loss from the sale of such property in an amount equal to the gain or loss that would have been allocated to the contributing partner under §704(c) as if the property had been sold for its fair market value at the time of the distribution. §704(c)(1)(B).
2. Under certain circumstances the distribution of property may be treated as part of a sale of the property under the disguised sale rules. §707(a)(2)(B).
3. If a partner has contributed property within 7 years of a distribution then the partner could recognize gain up to an amount equal to the built-in gain at the time of the contribution. §737(a).
4. Cash in excess of basis will be taxable. For this purpose distributions of marketable securities may be treated as cash. §731(c).

Partnership Distrib. — Marketable Securities

§731(c) generally treats any distribution of marketable securities as cash. Accordingly, subject to certain exceptions, a distributee partner will recognize gain to the extent of the receipt of marketable securities and cash in excess of the basis in partner's partnership interest the receipt of .

The general idea was to treat as cash the marketable securities received in effect, in exchange for is reduced the applicable partner's interest in other assets. A key component of this provision is that the marketable securities treated as cash by the excess of (1) the distributee's share of the net gain that would be recognized if the partnership sold all of its marketable securities immediately before the distribution over (2) the distributee's share of the net gain attributable to marketable securities held by the partnership after the distribution. Reg. §1.731-2(b)(2).

Example, Partnership ABC owns 300 shares of X corporation common stock, each with a basis of $10 and a value of $100, as well as other assets. ABC own ⅓ each of ABC. The X stock is considered marketable security, under §731(c)(2), and was neither contributed by A nor acquired by ABC in the nonrecognition transactions described in Reg. §1.701-2(d)(i)(ii). A is a partner and has a $5,000 basis. The X stock is distributed to A in complete liquidation of A's partnership interests. Under the general rule A would be deemed to have received $30,000 in cash, but such amount will reduced by $9,000 which is A's share of the applicable gain. The basis of the shares to A is determined under the normal rules and then increased by gain under §731(c).

Partnership Dist.

Cash is deemed to have been received first. §733(a).

Partner takes carry-over basis in the property. §732(a).

Partner's basis reduced by the basis of the property received. §733 & §705.

Limitation – partner cannot take a basis in the property greater than the partner's basis in the partnership. §732(a)(2).

Partnership Dist. — Liquidating

Distribution in liquidation of a partner's interest, like current distributions, are generally tax-free to both the partner and the partnership unless §737 or §751(b) applies.

If neither section applies, §731(a) applies and provides that (1) gain shall not be recognized except to the extent that any cash received exceeds the adjusted basis of the partnership interest of the applicable partner, and (2) loss shall be recognized if the distribution consists of only money and any unrealized receivable (as defined in §751(c)) and inventory (as defined in §751(d)). Loss recognized to the extent basis in the partnership interest exceeds cash plus the basis in the unrealized receivables and inventory (as determined under §732).

Partnership Dist. — Liquidating Basis

Generally, the basis in the partnership interest after any reduction for cash is substituted for the bases in any assets distributed (i.e., substituted basis).

Basis in Remaining Assets: Generally, no change. Basis adjustment for remaining assets if a §754 election is in place or the adjustment is mandatory. The adjustment is mandatory if there would have been a basis reduction of at least $250,000 if a §754 election had been in place. For example, if a partner had a basis in its partnership interest of $1MM received a property distribution in complete liquidation of his partnership interest and such property had a zero basis in the hands of the partnership then the following two things would occur (1) the partner gets the property with a basis of $1MM and (2) the partnership must reduce the basis in other assets by $1MM.

Partnership Dist. — Liquidating Basis

§732(b) provides that the basis of property distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of such partnership interest in the partnership reduced by any money distributed in the transaction.

Where a partner's interest in a partnership is to be liquidated by a series of distributions, the interest will not be considered as liquidated until the final distribution has been made. Reg. §1.761-1(d).

Basis adjustments for a series of payments is no clear but arguably basis should be reduced by the agreed amount of the cash distributions in determining the basis of any property distributed. Reg. §1.732-1(b), where it refers to "any money distributed to him in the same transaction." All payments in a series should be part of the same transaction.

Hot Assets – Disproportionate Dist.

When a distribution changes the recipient partner's interest in partnership "hot assets" (unrealized receivables or significantly appreciated inventory), Section 751 (b) triggers recognition of gain or income to the partner, the partnership or both.

Sale of a Partner’s Interest

Sale of an interest to an outside buyer is fully taxable.

Gain/loss measured as difference between amount realized from the sale and the partner’s tax basis.

- Amount realized is total selling price = cash received + value of any other property received + selling partner’s share of partnership debt being assumed by the buyer

Sale of a Partner's Interest – cont'd

If partnership interest exchanged for property, gain is recognized in an amount equal to the difference between the value of such property rec'd and the tax basis of the partnership interest.

Partial sale – tax basis is apportioned between the interest sold and the interest retained.

PARTNERSHIPS
Sale of Interest

Under certain circumstances the adjustments under §743 will be mandatory upon a transfer of a partnership interest by sale or exchange or upon death if the partnership has a substantial built-in loss, which exists if the partnership adjusted basis in the partnership property exceeds by more than $25,000 the fair market value of such property. Example, partnership A has assets with a combined bases of $5MM and a fair market value of $2MM. Partner C has a 40% and dies. The interest of C will be subject to the adjustments under §743 as if a §754 election had been made.

Death or Retirement of a Partner

Sec. 736 – Consequences depend on nature of payments to retiree or deceased partner's successor in interest

- Payments for partner's share of partnership "property" are treated as distributions and subject to same rules as other distributions
- Payments in excess of partner's share of p/s property treated as guaranteed payments or distributive shares of partnership income (and thus deductible by partnership or allocated away from existing partners)

Death or Retirement of a Partner

What constitutes partnership "property" under Code Sec. 736?

- Is capital a material income-producing factor for partnership?
  - Yes – property is everything except unrealized receivables
  - No – property is everything except unrealized receivables and goodwill
- Exception – goodwill is treated as property if required in partnership agreement

Income in Respect of a Decedent

Sec. 736(b) payments received by deceased partner's beneficiary will generally be nontaxable to recipient due to §1014 stepped-up basis rules.

Sec. 736(a) payments, in contrast, are generally treated as income in respect of a decedent and will be fully taxable to recipient.

Termination of Partnership

A partnership shall only be considered as terminated if:

A. No part of any business financial operation venture of the partnership continues to be carried by any of its partners, or

B. Within a 12 month period there is a sale or exchange of 50% or more of the total interest in capital and profits.

Additional Special Rules apply to mergers and divisions of partnerships. §708.

Termination of Partnership cont'd

For this purpose sale or exchange does not include:

1. Contributions
2. Distributions (including liquidation)
3. Gift
4. Bequest or inheritance.

If an upper tier partnership terminates it will be treated as exchanging its entire interest in any lower tier partnership.

If the upper tier partnership does not terminate then there is no impact on the lower tier partnership.

Termination of Partnership cont'd

If a partnership is terminated by a sale or exchanges of 50% or more the following is deemed to occur. The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership, and immediately thereafter the terminated partnership distributes interests in the new partnership to the purchasing partners and other partners in liquidation of the terminated partnership. Reg.§1.708-1(b)(4)

Termination of partnership—Closing of taxable year

The taxable year of a partnership with respect to a partner (not the entire partnership) shall close with respect to a partner whose entire interest in the partnership terminates (whether by reason of death, liquidation or otherwise). §706(c)(2)(A).

The taxable year of the partnership shall close in the case of a termination of the partnership, which includes a sale of 50% or more of the interest in a partnership within a 12 month period. §706(c)(1).

Partnership is not terminated with death if the estate continues to serve as partner.

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May 5, 2014

VIA U.S. MAIL & FEDERAL eRULEMAKING PORTAL
HTTP://WWW.REGULATIONS.GOV

Mr. John Koskinen
Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20024

CC:PA:LPD:PR (REG-144468-05)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

RE: Comments on Proposed Treasury Regulations Section 1.704-3

Dear Commissioner Koskinen:

On January 16, 2014, the Internal Revenue Service (the "IRS" or "Service") and the Department of the Treasury ("Treasury") released REG-144468-05 regarding Proposed Treasury Regulations Sections 1.704-3, 1.704-4, 1.732-2, 1.734-1, 1.734-2, 1.737-1, 1.743-1, 1.755-1, and 1.1502-13 (the "Proposed Regulations"). In the Preamble to the Proposed Regulations, the Service and Treasury requested comments on the Proposed Regulations. On behalf of the Tax Section of the State Bar of Texas, I am pleased to submit the following comments on the Proposed Regulations.

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 SECTION OF TAXATION, 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 Service for the time and thought that has been put into preparing the Proposed Regulations, and we appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

Elizabeth Copeland

Elizabeth Copeland
Chair, Tax Section
State Bar of Texas

COMMENTS ON PROPOSED TREASURY REGULATIONS SECTION 1.704-3, AS PUBLISHED IN THE FEDERAL REGISTER ON JANUARY 16, 2014

Principal responsibility for drafting these comments was exercised by Brandon Bloom. The Committee on Government Submissions (COGS) of the Tax Section of the State Bar of Texas has approved these comments. J. F. (Jack) Howell III reviewed the comments and made substantive suggestions on behalf of COGS. Robert Probasco, Co-Chair of COGS, also reviewed the comments 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: Brandon Bloom
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(214) 969-1106

Date: May 5, 2014

I. BACKGROUND

A. Proposed Regulations

Under Section 704(c)(1)(C), when a partner contributes property with fair market value less than basis ("built-in loss property") to a partnership , the built-in loss can be taken into account only in determining the amount of items allocated to the contributing partner. Section 704(c)(1)(C)(ii) further provides in determining the amount of items allocated to other partners, the basis of built-in loss property in the hands of the partnership is treated as equal to the fair market value of such property. The Proposed Regulations generally apply to any Section 704(c) property with a built-in loss (*i.e.*, an excess of basis over fair market value).

The Proposed Regulations deal with built-in loss property by creating a "basis adjustment" that is unique to the contributing partner, similar to basis adjustments under Section 743(b), which are unique to the transferee partner. Initially, the amount of the basis adjustment is the amount of the built-loss at the time of the contribution of the property and is then subsequently adjusted for cost recovery deductions in accordance with the Proposed Regulations.[1] Thus, while the partnership's basis in the built-in loss property is treated as equal to its fair market value (*i.e.*, stepped down), the contributing partner maintains its high basis in the property through the basis adjustment, which is solely for the benefit of the contributing partner.[2]

The Proposed Regulations provide that in allocating items of income, gain, loss and deduction, a partnership first computes such items under Section 703 at the partnership level, excluding the effect of the basis adjustment, and allocates such items among the partners. The partnership then adjusts the contributing partner's distributive share of such items to reflect the effect of the basis adjustment.[3] A contributing partner's share of income, gain or loss upon a sale or disposition of built-in loss property is equal to such partner's share of the partnership's income, gain or loss, minus the amount of the basis adjustment for such property.[4]

If the built-in loss property is subject to depreciation, amortization or other cost recovery, then the basis adjustment is recovered through such cost recovery deductions, and the contributing partner is allocated the depreciation, amortization or other cost recover deductions attributable to the basis adjustment.[5]

B. Allocation of Depletable Basis Among Partners

Under Section 613A(c)(7(D), depletion deductions with respect to oil and gas properties held by a partnership are computed separately by the partners, rather than the partnership. In order to carry out this provision, the basis of a partnership's oil and gas properties is held outside the partnership by the partners. Section 613A(c)(7)(D) requires the partnership to allocate the basis of such property among the partners as follows:

---

[1] Prop. Reg. § 1.704-3(f)(2)(iii).
[2] Prop. Reg. § 1.704-3(f)(3)(ii)(A).
[3] Prop. Reg. § 1.704-3(f)(3)(ii)(B).
[4] Prop. Reg. § 1.704-3(f)(3)(ii)(C).
[5] Prop. Reg. § 1.704-3(f)(3)(ii)(D).

> The partnership shall allocate to each partner his proportionate share of the adjusted basis of each partnership oil or gas property. The allocation is to be made as of…the date of acquisition of the oil or gas property by the partnership…. A partner's proportionate share of the adjusted basis of partnership property shall be determined in accordance with his interest in partnership capital or income and, <u>in the case of property contributed to the partnership by a partner, section 704(c) (relating to contributed property) shall apply in determining such share</u>. Each partner shall separately keep records of his share of the adjusted basis in each oil and gas property of the partnership, adjust such share of the adjusted basis for any depletion taken on such property, and use such adjusted basis each year in the computation of his cost depletion or in the computation of his gain or loss on the disposition of such property by the partnership. (emphasis added)

On its face, Section 704(c) does not apply to allocate tax basis. Rather, it applies to allocate items of income, gain, loss and deduction. Further, beyond the general statements of principle found in the rule above governing partnership oil and gas properties under Section 613A(c)(7)(D), there is little technical guidance as to how Section 704(c) affects the allocation of basis of oil and gas properties. The Proposed Regulations provide an excellent opportunity to begin to fill in this gap.

II. COMMENTS

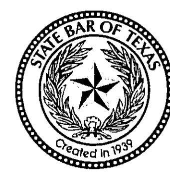
We recommend that Prop. Reg. § 1.704-3(f)(3)(ii)(A) be clarified by adding the following sentence to the end of that provision:

> The section 704(c)(1)(C) basis adjustment with respect to a partnership oil and gas property subject to section 613A(c)(7)(D) shall be included in the section 704(c)(1)(C) partner's allocable share of the adjusted basis of such property under section 613A(c)(7)(D).

We also recommend that Prop. Reg. § 1.704-3(f)(3)(ii)(D)(1) be clarified by adding the following sentence to the end of that provision:

> In accordance with section 613A(c)(7)(D) and paragraph (f)(3)(ii)(A) of this section, the depletion allowance attributable to the section 704(c)(1)(C) basis adjustment with respect to a partnership oil and gas property shall be computed separately by the section 704(c)(1)(C) partner and not by the partnership.

SECTION OF TAXATION
State Bar of Texas



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Law School Representative
Abbey B. Garber (Dallas)
IRS Representative
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Comptroller Representative

March 19, 2014

Yvette Lawrence
Internal Revenue Service
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1111 Constitution Avenue N.W.
Washington, DC 20224

Re: Comments of the Section of Taxation of the State Bar of Texas on Income, Gift and Estate Tax; OMB Number: 1545-1360; Regulation Project Number: PS-102-88 (T.D.8612)

Dear Ladies and Gentlemen:

On December 24, 2013, the Department of Treasury and the Internal Revenue Service requested comments on the collection of information under the Qualified Domestic Trust Treasury Regulations of the Internal Revenue Code (commonly referred to as the "QDOT Regulations") in connection with the availability of the gift and estate tax marital deduction when the donee spouse or surviving spouse is not a citizen of the United States. On behalf of the Section of Taxation of the State Bar of Texas (the "Tax Section"), I am pleased to submit the following comments concerning the collection of information under the QDOT Regulations.

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 appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

Elizabeth A. Copeland
Chair, Section of Taxation
The State Bar of Texas

RESPONSE TO REQUEST FOR COMMENTS ON INCOME, GIFT AND ESTATE TAX OMB NUMBER: 1545-1360 REGULATION PROJECT NUMBER: PS-102-88 (T. D. 8612)

This response to the request for comments with respect to information collected under the Qualified Domestic Trust Treasury Regulations of the Internal Revenue Code is presented on behalf of the Section of Taxation of the State Bar of Texas (the "Tax Section").

Principal responsibility for drafting these comments was exercised by Catherine C. Scheid and Austin Carlson. The Committee on Government Submissions ("COGS") of the Tax Section has approved these comments. Tina R. Green, immediate past Chair of the Tax Section, reviewed the comments and made suggestions on behalf of COGS. Stephanie Schroepfer, the Co-Chair of COGS, also reviewed the comments on behalf of COGS.

Although members of the Tax Section who participated in preparing, reviewing and approving these Comments have clients who would be affected by the federal tax law principles addressed by these Comments and 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 Persons:

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Date: March 3, 2014

These comments address certain issues relating to the instructions of the IRS Form 706-QDT and the annual reporting requirements in Treasury Regulation §20.2056A-2(d)(3).

Background

For decedents dying after November 10, 1988, the Federal estate tax marital deduction is not allowed for property passing to or for the benefit of a surviving spouse who is not a United States citizen at the date of the decedent's death unless the property passes from the decedent (i) to a qualified domestic trust (a "QDOT"), (ii) a reformed QDOT, (iii) to a surviving spouse that places the property in a QDOT or irrevocably assigns the property to a QDOT, or (iv) the property passes from the decedent to a plan that would have qualified for the marital deduction but for Section 2056(d)(1)(A) of the Internal Revenue Code and whose payments are not assignable to a QDOT and the executor makes a timely QDOT election.

Summary of Comments

We respectfully recommend that the Department of Treasury (the "Treasury") and the Internal Revenue Service (the "IRS") consider making additions to the instructions for Form 706-QDT in the Supplemental Documents Section to (1) inform tax practitioners about the situations for

which a written statement would be required under Treas. Reg. §20.2056A-2(d)(3) and (2) explain that Form 706-QDT must be filed if a written statement is required under Treas. Reg. §20.2056A-2(d)(3) (solely to accommodate the requirement of the filing of the written statement), as this will enhance the quality, utility, and clarity of the information to be collected.

Further, in our view, the pro rata share section of Treas. Reg. §20.2056A-2(d)(3)(iii)(B) of the contents of the written statement is overly burdensome, and we respectfully recommend that a "reasonable estimation" of fair market value be authorized by the Treasury and the IRS to minimize the burden of the collection of information.

Discussion

While the Supplemental Documents section of the Form 706-QDT Instructions requires attaching a copy of the trust and a copy of the death certificate, there is presently no mention in the Form 706-QDT Instructions about the written statement that is referred to in Treas. Reg. §20.2056A-2(d)(3)(ii).

Under the Regulations, the written statement is required in the following situations:

(i) the QDOT directly owns any foreign real property on the last day of its taxable year and the QDOT does not meet the Bank Trustee requirement, the Bond Requirement, the Letter of Credit Requirement or have either an alternate arrangement or Waiver with the Commissioner of the IRS;

(ii) the personal residence which was excluded from the bond, letter of credit or other arrangement was sold or is no longer being used as a personal residence of the spouse; or

(iii) after applying the look through rule, the QDOT is treated as owning foreign real property on the last day of its taxable year and the QDOT does not meet the Bank Trustee requirement, the Bond Requirement, the Letter of Credit Requirement or have either an alternate arrangement or Waiver with the Commissioner of the IRS.

We believe that additional guidance for taxpayers and practitioners in the Form 706-QDT Instructions concerning the above complex situations would be helpful and will enhance the quality, utility, and clarity of the information that is collected. While there is mention of Treas. Reg. §20.2056A-2(d) concerning the "Additional Information" section of the Form 706-QDT Instructions, there appears to be an unintentional dearth of guidance in the Additional Information section of the Form 706-QDT Instructions concerning the circumstances in which a written statement is required to be filed under the QDOT Regulations. We recommend that the Treasury and the IRS consider adding specific language to the Form 706-QDT Instructions informing taxpayers of the specific situations for which a written statement is required, and the required contents of the written statement. We also recommend adding to the Form 706-QDT Instructions explicit guidance that a Form 706-QDT may need to be filed for the sole purpose of accommodating the filing of the written statement where the written statement is required.

In our view, certain of the contents of the written statement outlined in Treas. Reg. §20.2056A-2(d)(3)(iii) are overly burdensome. Specifically, the requirement under Treas. Reg. §20.2056A-2(d)(3)(iii)(B) that "the QDOT's pro rata share of the foreign real property and other assets owned by that entity must be listed on that statement as if directly owned by the QDOT". The assets are required to be listed at fair market value as of the last day of the QDOT's taxable year. This presents the challenging task of evaluating assets that are not directly owned by the QDOT

and that may not have a readily ascertainable fair market value. We recommend that the Treasury and the IRS consider amending the language of Treas. Reg. §20.2056A-2(d)(3)(iii)(B) to allow for a "reasonable estimation" of fair market value to minimize the burden of the collection of information.

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April 4, 2014

Teresa G. Bostick
Texas Comptroller of Public Accounts
Manager, Tax Policy Division
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Austin, TX 78711-3528

Re: Comments of the Section of Taxation of the State Bar of Texas Response to Texas Comptroller Request for Comments Pertaining to New Rule 3.11

Dear Ms. Bostick:

On March 19, 2014, the Texas Comptroller of Public Accounts ("Comptroller") requested comments on a draft of a proposed new general rule at 34 Tex. Admin. Code § 3.11 ("Rule 3.11") pertaining to settlements on redetermination (including insolvency considerations). On behalf of the Section of Taxation of the State Bar of Texas (the "Tax Section"), I am pleased to submit the following comments concerning settlements on redetermination (including insolvency considerations) as set out in the proposed draft new Rule 3.11.

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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We appreciate being extended the opportunity to participate in this process.

Respectfully submitted,

Elizabeth A. Copeland
Chair, Section of Taxation
The State Bar of Texas

RESPONSE TO REQUEST FOR COMMENTS REGARDING A DRAFT OF PROPOSED NEW RULE 3.11, SETTLEMENTS ON REDETERMINATION

This response to request for comments with respect to newly proposed Comptroller Rule 3.11 is presented on behalf of the Section of Taxation of the State Bar of Texas (the "Section"). The principal drafters of these comments are Ira Lipstet, Chair of the Section's Committee on State and Local Taxation, Charolette F. Noel and Sam Megally, Vice-Chairs of the Section's Committee on State and Local Taxation, and Alyson Outenreath, Secretary of the Section and member of the Section's Committee on State and Local Taxation. Other members of the Section's Committee on State and Local Taxation providing input include: Eleanor Kim, David Gilliland, and Christopher Bourell. The Section's Committee on Government Submissions ("COGS") has approved these comments. Dan Micciche, past Chair of the Section, reviewed the comments and made suggestions on behalf of COGS. Stephanie Schroepfer, the Co-Chair of COGS, also reviewed the comments on behalf of COGS.

Although many of the people who participated in preparing, reviewing and approving these comments have clients who will be affected by the Texas tax law principles addressed by these comments and frequently advise clients on the application of such principles, none of the participants (or the firms or organizations to which such participants belong) has been engaged by a client to make a government submission with respect to, or otherwise influence the development or outcome of, the subject matter of these comments.

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Date: April 4, 2014

I. INTRODUCTION

This comment letter is in response to the request of the Texas Comptroller of Public Accounts (the "Comptroller") for comments concerning newly proposed Comptroller Rule 3.11 relating to Settlements on Redetermination ("Proposed Rule § 3.11").[1]

We recognize and appreciate the desire of the Comptroller to provide useful and reliable tax guidance in the form of Rules that will promote and enhance the efficiency and voluntary compliance with Texas tax laws. We also want to express our appreciation to the Comptroller personnel for their efforts to encourage a dialog on the issues concerning Proposed Rule § 3.11. It is our intent to present items for further consideration that may help and support the Comptroller and Comptroller personnel in finalizing Proposed Rule § 3.11.

The focus in these comments is on possible areas in which Proposed Rule § 3.11 appears to vary from, and in some instances be broader or narrower than, Tex. Tax Code § 111.102, which is the corresponding statute that Proposed Rule § 3.11 seeks to implement. Following are comments and suggestions addressing this issue.

II. PROPOSED RULE § 3.11 COMMENTS

A. Intent of Tex. Tax Code § 111.102

Based upon language included in the preamble, the purpose of Proposed Rule § 3.11, in part, is to clarify that the intent of Tex. Tax Code § 111.102 is to "give the Comptroller discretion to compromise a tax claim when the compromise benefits the state." The preamble goes on to say that Tex. Tax Code § 111.102 "does not provide relief to individual taxpayers based on inability to pay" and that "[s]ettlements based on inability to pay are addressed in the collection process by the Enforcement Division, and not specifically authorized in Tax Code § 111.102."

Tex. Tax Code § 111.102 states:

> As part of a redetermination order, the comptroller may settle a claim for a tax, penalty, or interest imposed by this title if:
>
> (1) collection of the total amount due would make the taxpayer insolvent and the taxpayer has submitted to the comptroller all financial records, including income tax reports and an inventory of all property owned wherever located; or
> (2) the taxpayer is insolvent, is in liquidation, or has ceased to do business and:
>   (A) the taxpayer has no property that may be seized by the courts of this or another state; or

[1] All references to "Rule" are to Chapter 34 of the Texas Administrative Code.

(B) the value of the taxpayer's property is less than the total amount due and the amount of debts against the property.

We understand it is the Comptroller's position that settlements based on inability to pay are to be handled by the Enforcement Division and not through a settlement request under Tex. Tax Code § 111.102 (sometimes referred to herein as the "inability to pay policy"). However, Tex. Tax Code § 111.102 does not prohibit the Comptroller's office from settling cases based on inability to pay. Indeed, the language of Tex. Tax Code § 111.102 provides that the Comptroller may settle a claim if payment would (1) make the taxpayer insolvent or (2) if the taxpayer is insolvent, in liquidation, or has ceased to do business and the taxpayer has insufficient property that may be seized by the courts or the value of the taxpayer's property is less than the total amount due and the amount of debts against the property. Broadly speaking, all of these instances involve an inability to pay. Thus, the preamble language in Proposed Rule § 3.11 that sets forth the Comptroller's proposed policy to deny consideration of settlements based on inability to pay may be confusing to taxpayers and may, in fact, limit the instances in which Tex. Tax Code § 111.102 allows taxpayers to make settlement requests.

Further, restricting the ability of a hearings attorney to settle certain cases could be burdensome to taxpayers and detrimental to the Comptroller. Many taxpayers seeking settlements may appear pro se and likely have a difficult enough time navigating the redetermination hearing process. Requiring some settlements, but not all, to be handled by the Enforcement Division instead of directly through the hearings attorney may unnecessarily complicate the settlement process and cause a taxpayer to inadvertently waive an otherwise available right to settlement because the procedure of navigating through multiple departments within the Comptroller's office ultimately becomes too confusing or too burdensome. Disallowing settlements in this manner may especially discourage pro se and small business taxpayers from attempting to settle with the Comptroller because of a perceived unwillingness on the part of the Comptroller to settle – thereby reducing the amounts of tax that the Comptroller might otherwise have been able to collect.

We suggest the Comptroller consider changing the inability to pay policy and allow taxpayers in the redetermination hearing process to settle their cases in whole or in part based on inability to pay. A change in policy would require deleting the following two sentences from the preamble to Proposed Rule § 3.11: "The statute does not provide relief to individual taxpayers based on inability to pay. Settlements based on inability to pay are addressed in the collection process by the Enforcement Division, and not specifically authorized in Tax Code § 111.102."

If the Comptroller declines to change the inability to pay policy, we suggest the following modifications/clarifications be made to Proposed Rule § 3.11:

- Amend the preamble to Proposed Rule § 3.11 to provide the underlying authority for the policy. Taxpayers and practitioners would benefit from knowing the specific underlying authority.

- Clarify whether the inability to pay policy applies equally to taxpayers who are individuals and taxpayers that are entities. The preamble to Proposed Rule § 3.11 currently states: "The statute does not provide relief to *individual* taxpayers based on inability to pay." (Emphasis added).
- Amend Proposed Rule § 3.11 to add a subsection (h) that specifically states that a taxpayer will not be able to enter into a settlement based on inability to pay as part of the redetermination hearing process and provide taxpayers with a cross-reference to the applicable statute/Rule governing the procedure for entering into inability to pay settlements with the Enforcement Division. Many taxpayers (especially small business and/or pro se taxpayers) will not know to seek out the preamble to the proposed or final rules for additional information beyond what is contained in the body of the rule. Therefore, taxpayers will benefit from the Comptroller specifically setting forth the inability to pay policy in the actual language of Proposed Rule § 3.11 rather than only including it in the preamble.
- Change the title of Proposed Rule § 3.11 from "Settlements on Redetermination" to "Settlements on Redetermination Based on Insolvency" or something similar. A narrower title would be more congruent with the limited application of Proposed Rule § 3.11.

Taxpayers and practitioners could benefit from the Comptroller explaining in the body of Rule § 3.11 the role of the Settlement Coordinator in redetermination hearings as well as how to make contact with the Settlement Coordinator (or his designee) as may be necessary.

B. Insolvency Definition

Proposed Rule § 3.11(a)(2) defines the term "insolvent" to mean "unable to pay debts as they become due." We believe the current definition of insolvent in Proposed Rule § 3.11(a)(2) may narrow the definition of insolvent to less than what is contemplated by Chapter 111 of the Texas Tax Code. For example, Tex. Tax Code § 111.012(f)(2)(D) provides that the Comptroller can require a taxpayer to establish a tax escrow account if the Comptroller determines that the taxpayer "is insolvent *because the taxpayer's liabilities exceed the taxpayer's assets* or the taxpayer is unable to pay the taxpayer's debts as they become due." (Emphasis added). It is unclear to us why Tex. Tax Code § 111.102 would contemplate a different definition of the term "insolvent" than Tex. Tax Code § 111.012. Indeed, there are situations where a taxpayer's liabilities can exceed assets, but the taxpayer is still technically able to pay debts as they become due (even if such payments might cause problems with continuing viability of the business). This situation could arise when a taxpayer has cash or cash equivalents, but no other assets, and a large amount of liabilities, with such combination creating negative equity. In this situation, the taxpayer could be insolvent even though such taxpayer might have cash available to pay debts as they become due.

Additionally, certain Comptroller Decisions have stated that the term "insolvent" for purposes of Tex. Tax Code § 111.102 means a circumstance where liabilities exceed assets *or* where a taxpayer's obligations cannot be paid as they become due. *See, e.g.,*

Comp. Dec. No. 105,998 (2013) ("Under generally accepted definitions of insolvency, an entity is insolvent if its liabilities exceed its assets, or if its obligations cannot be paid as they become due."). *See also* Comp. Dec. No. 33,143 (1995) ("There are generally two acceptable definitions of insolvency. The first is insolvency exists if liabilities exceed assets. The second is insolvency exists if obligations cannot be paid as they become due.").

For the foregoing reasons, we suggest the Comptroller revise the definition of "insolvent" in Proposed Rule § 3.11(a)(2) to be consistent with the definition used elsewhere in Chapter 111 of the Texas Tax Code and how it has been interpreted in the past. This could be accomplished by amending the definition of "insolvent" in Proposed Rule § 3.11(a)(2) to read as follows:

"(2) Insolvent—For purposes of this section, the taxpayer's liabilities exceed the taxpayer's assets or the taxpayer is unable to pay the taxpayer's debts as they become due."

C. Procedural Requirements

Subsection (c) of Proposed Rule § 3.11 requires a taxpayer to request a settlement pursuant to Tex. Tax Code § 111.102 in the Statement of Grounds filed with a timely redetermination request or a timely amendment to the Statement of Grounds. We recognize and appreciate the general need for the Comptroller to establish procedural guidelines for settlements. However, requiring a taxpayer to request a settlement pursuant to Tex. Tax Code § 111.102 in a timely filed or timely amended Statement of Grounds may be a trap for the unwary for certain taxpayers. As previously discussed, taxpayers requesting a settlement under Tex. Tax Code § 111.102 may likely be appearing pro se or with very limited access to tax advisors. It could be reasonable for any taxpayer, but most certainly a pro se or struggling small business taxpayer, to believe a settlement could be negotiated with the hearings attorney without the need of first going through a formal filing process or else risk losing the equitable right. Further, such strict timing and procedural requirements were not statutorily mandated by the Legislature when Tex. Tax Code § 111.102 was enacted. There is no provision in Tex. Tax Code § 111.102 that would place such a limitation on settlements in redetermination proceedings. If the conditions that would otherwise warrant settlement occur after the filing of the Statement of Grounds, foreclosing all consideration of settlement would not appear to be in the best interest of the Comptroller or the taxpayer.

We believe taxpayers may see the strict timing and procedural requirements of Proposed Rule § 3.11(c) as unreasonable. We also believe it has the potential to create a trap for the unwary. We suggest the Comptroller delete Subsection (c) of Proposed Rule § 3.11 in its entirety. If the Comptroller declines to delete Subsection (c) in its entirety, then at a minimum it would seem a cross-reference to Proposed Rule § 3.11 would be necessary in Rule 1.5, Rule 1.7, and all Comptroller publications concerning the redetermination hearing process.

D. Instances of Bankruptcy and Ceasing to Do Business

Proposed Rule § 3.11 provides that a taxpayer may request a settlement if "(1) the taxpayer is not insolvent and collection of the total amount due would make the taxpayer insolvent, or (2) the taxpayer is insolvent, in bankruptcy, or in liquidation and has no property or insufficient value in property to satisfy all or a portion of the tax claim."

Texas Tax Code § 111.102, however, states that a taxpayer may request a settlement if:

> (1) collection of the total amount due would make the taxpayer insolvent and the taxpayer has submitted to the comptroller all financial records, including income tax reports and an inventory of all property owned wherever located; or
>
> (2) the taxpayer is insolvent, *is in liquidation, or has ceased to do business* (emphasis added) and:
>
> > (A) the taxpayer has no property that may be seized by the courts of this or another state; or
> > (B) the value of the taxpayer's property is less than the total amount due and the amount of debts against the property.

(Emphasis added).

Thus, it seems that, at least in some cases, Proposed Rule § 3.11 allows a taxpayer to request a settlement in a different range of situations than the ones the Comptroller is actually allowed to settle per Tex. Tax Code § 111.102. For example, Proposed Rule § 3.11 allows a settlement request when a taxpayer is in bankruptcy, but a taxpayer in bankruptcy may not necessarily satisfy all the criteria set forth in Tex. Tax Code § 111.102. On the other hand, Tex. Tax Code § 111.102 allows a settlement request when a taxpayer has ceased to do business and certain other requirements are satisfied, but Proposed Rule § 3.11 does not allow a settlement request based on the cessation of business.

Effectively, Proposed Rule § 3.11 appears to delete cessation of business as a situation where a taxpayer can request a settlement and replaces it with the instance of bankruptcy. The Comptroller may believe the term bankruptcy equates to cessation of business, but such is not necessarily true because not all debtors in bankruptcy have ceased (or will cease) to do business. The best example of this is a Chapter 11 bankruptcy filing, which is intended to keep the debtor from going out of business.[2] Additionally, the instance of cessation of business is not necessarily included generally within the meanings of the terms insolvent, bankruptcy, or liquidation. Certainly a taxpayer could cease all business without being insolvent, in bankruptcy, or in liquidation. Therefore, it appears there is a possible subset of claims that are covered by Tex. Tax Code § 111.102 but that are not included in Proposed Rule § 3.11 and vice

[2] While many Chapter 11 debtors will satisfy the insolvency requirement, some may not.

versa. We suggest that Proposed Rule § 3.11 be amended to specifically track Tex. Tax Code § 111.102.[3]

Further, subparagraphs (A) and (B) of subsection (2) of Tex. Tax Code § 111.102 contain Comptroller imposed requirements for a taxpayer to request a settlement that are different from and more limiting than those set forth in Proposed Rule § 3.11. For instance, Tex. Tax Code § 111.102(2) provides that a taxpayer may request a settlement only when the taxpayer "has no property that may be seized by the courts of this or another state" or "the value of the taxpayer's property is less than the total amount due and the amount of debts against the property." In contrast, corresponding subsection (b)(2) in Proposed Rule § 3.11 provides that a settlement can be requested when the taxpayer "has no property or insufficient value in property to satisfy all or a portion of the tax claim." Thus, the language of Proposed Rule § 3.11 is arguably narrower than the corresponding statutory language. We do not see a reason why the requirements in Proposed Rule § 3.11 should differ from, and be narrower than, those set forth in Tex. Tax Code § 111.102. Thus, this is another instance where we suggest that Proposed Rule § 3.11 be amended to track the language (and apparent intent of the legislature) in Tex. Tax Code § 111.102.

E. Definition of Settlement and Payment Agreements

Proposed Rule § 3.11(a)(1) provides that the term settlement means "[t]ax, penalty, and interest waivers or reductions." Proposed Rule § 3.11(a)(1) goes on to state that "[p]ayment agreements are not settlements under this section." Taxpayers and practitioners could benefit from Proposed Rule § 3.11(a) also setting forth a definition (or cross-reference to a definition) of the term payment agreement. We suggest the Comptroller amend Proposed Rule § 3.11(a) to provide this information.

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[3] We understand that the Comptroller has a long-standing policy that relief under Tex. Tax Code § 111.102 is not appropriate for taxpayers who are no longer in business. *See, e.g.*, Tex. Comp. Dec. 39,808 (2003) (". . . [A]s the Administrative Hearings Section notes, historically the Comptroller has denied insolvency relief for taxpayers that are no longer in business. In Comptroller's Decision No. 37,535 (1999), the Comptroller held that as 'a general rule, the Comptroller will exercise his discretion to forgive a tax liability under Section 111.102 if the business is a going concern and the state would benefit through the forgiveness of all or a part of the liability, but allowing the business to continue operating, generating future tax revenues, and providing employment opportunities. Several Comptroller Decisions have indicated that there is little or no benefit to be gained by the state in the settling of a business liability where the business essentially exists in name only. *See* Comptroller's Decision Nos. 30,273 (1993), 29,233 (1992), and 33,050 (1996).'"). *See also* Comp. Dec. 105,317 (2013) (". . . [T]he Comptroller has a long-standing policy that it is generally not in the State's best interest to offer an insolvency settlement to a corporate taxpayer that has ceased operating a business"); Comp. Dec. 100,117 (2008) (. . . "[T]he Comptroller has a long standing policy that generally does not allow an insolvency settlement when: (a) the taxpayer is out of business, (b) the assessment is for tax collected not remitted, or (c) there is fraud penalty assessment.").

The omission in Proposed Rule § 3.11 of "ceased to do business" as an instance in which Tex. Tax Code § 111.102 relief can be requested by a taxpayer appears to indicate the Comptroller's formal adoption of that policy. However, this long-standing policy of the Comptroller (including hearing decisions) appears to be in direct conflict with the statutory language of Tex. Tax Code § 111.102. Adopting a rule which is (in part) inconsistent with the relevant statutory language is typically considered to be beyond the authority of the promulgating agency. Furthermore, this limits the ability of the Comptroller to collect amounts from businesses that are effectively out of business but still have some ability to pay. Accordingly, we suggest such policy not be adopted as part of Proposed Rule § 3.11.

F. Requiring Information from Non-Taxpayers as a Prerequisite for Settlement

Proposed Rule §3.11(e) specifies that the Comptroller may request "other records and information to review a settlement request such as documentation of assets, liabilities, and ongoing financial obligations of the taxpayer ***or related entities and individuals, including individuals who hold an interest in, or are a member, officer or director of the taxpayer (emphasis added).*** The taxpayer must submit these records within 30 days of a comptroller written request to produce them."

A requirement that non-taxpayer entities (whether individuals or non-individual legal entities) produce financial information as a prerequisite to consideration of a settlement offer by a different taxpayer simply does not exist in any statutory authority and may create an impossible criteria to meet, particularly where the taxpayer lacks control over the other party. Such a practice would disregard the long-standing policy and authority which (absent some statutory basis to the contrary) treats individuals and legal entities as taxpayers separate and apart from one another – even when there is some equity interest or other relationship in place.

There is ample existing authority allowing the Comptroller to pursue officers and directors (or other responsible persons) for tax obligations of an entity in which they hold a fiduciary responsibility. By way of example this includes (but is not limited to) Tex. Tax Code § 171.255 (allowing personal liability of officers and directors upon a taxable entity's forfeiture of corporate privileges); § 111.016 (allowing collection of trust fund taxes collected and not remitted by responsible persons) and § 111.020 (authorizing collection of pre-transfer tax obligations from a successor when proper procedure has not been followed by the successor).

There can be (and sometimes are) situations where good faith attempts to operate a profitable business have failed, all assets available to the Comptroller from that entity have been obtained and there is still some unpaid tax obligation of the entity. An equity owner or other party related to the business may be inclined to provide some amount to settle the outstanding tax liability even if there is no legal obligation to do so. It appears unlikely, however, that such a prospective payor would attempt to settle the outstanding tax liability if required to provide financial information that may have nothing at all to do with the taxable entity. Furthermore, imposing such a requirement is apt to have a chilling effect on settlement offers funded by non-taxpayers. This would have the result of lowering tax collections that the Comptroller might otherwise have been able to obtain. For those reasons we suggest elimination of the language in proposed Rule 3.11 which would require financial information from non-taxpayers as a prerequisite for settlement consideration.

III. CONCLUSION

We greatly appreciate the opportunity to work with the Comptroller's office on this significant issue and hope that these comments are helpful to you as you craft the final rule relating to settlements on redetermination. Thank you for your consideration.