VOL 8
JULY 2013

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ABC'S OF HEALTHCARE FRAUD

BY SARAH Q. WIRSKYE, J.D., CPA

Healthcare fraud has been an investigative priority since 1996 when the Health Insurance Portability and Accountability Act established a National Healthcare Fraud and Abuse Control Program to coordinate federal, state, and local law enforcement regarding healthcare fraud and abuse. Since that time, the federal government has recovered over $18 billion for healthcare fraud and abuse, $2.5 billion of which was awarded or negotiated in fiscal year 2010.

The states have also ramped up their enforcement efforts in this area in recent years. State and federal investigations resulted in Medicaid recoveries exceeding $683 million in fiscal year 2010. Also in 2010, Texas Medicaid alone recovered $418 million and avoided costs of approximately $333,000 due to healthcare fraud enforcement. Texas is focusing on its investigations in a number of areas, including orthodontic and dental, home health and audiology centers. Ironically, these are some of the same areas in which the State has encouraged providers to offer services.

POTENTIALLY PROBLEMATIC CONDUCT

While there are slight variations depending on the type of practice, the government generally focuses on the same basic areas in healthcare fraud cases. In light of that, there are some things that you can do in order to minimize your liability if you find yourself under audit or investigation. (It is important to note that if you are currently under audit or investigation, you need to retain an attorney experienced in this area of the law to guide you through this process and any changes you may be implementing).

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THE REVISED TEXAS FRANCHISE TAX — TEXAS IS NOW EVEN MORE BUSINESS FRIENDLY

BY STEPHEN A. BECK, J.D., LL.M.

On June 14, 2013, Governor Perry signed into law H.B. 500, which provides $714 million of tax relief under the Texas franchise tax through temporary tax rate cuts, the permanent extension of the $1 million exemption, and targeted benefits for certain industries. The principal changes made to the Texas franchise tax by the new law are summarized below.

I. TEMPORARY RATE CUTS

H.B. 500 provides for temporary cuts in the franchise tax rate for reports filed during 2014 and potentially 2015.

A. For 2014, the generally applicable franchise tax rate will be decreased to .975% (from 1%), and the rate applying to retailers or wholesalers will be decreased to .4875% (from .5%).

B. For 2015, the generally applicable franchise tax rate may be further decreased to .95%, and the rate applying to retailers or wholesalers may be further decreased to .475%. These changes for 2015, however, are contingent on the Comptroller certifying after August 31, 2014 that the estimated probable state revenue exceeds a certain target. If there is no such

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ABC's of Healthcare Fraud, cont. from p. 1

SERVICES NOT RENDERED

The government often examines whether or not services that were billed were actually rendered. One of the government's favorite techniques for doing so is examining the amount of time the provider spends with each patient. In other words, the government divides the number of hours the provider is in the office by the number of patients seen during that day. If the time per patient is unreasonable in the government's opinion, it frequently takes the position that the provider did not see all of the patients and/or did not see the patients long enough to adequately provide the service. The government has an even stronger case in situations where the billing codes are time based. The government will frequently examine a provider's travel records to determine which days he or she was in the office, and compare that analysis with their billing records.

Services not rendered are perhaps one of the most critical issues that the government will examine. If the government concludes that unqualified personnel, such as assistants, must be treating patients because of the number of patients seen and/or the provider is not spending adequate time with each patient, the government views this as a quality of care issue. When there is a quality of care issue, the government is much more likely to suspend payments or shut down an office. If services are not being rendered at all, a criminal indictment is much more likely.

The provider needs to ensure that he or she is spending adequate time with each patient. It is also helpful to have the appropriate provider document and sign the charts contemporaneously upon treatment instead of at a later time. Such a policy can help "prove" that the provider personally provided the service.

NECESSITY

Necessity is another critical issue in government investigations. If the government can successfully challenge the determination of necessity, then in certain areas, the government will likely take the position that all charges paid for a patient were improper.

The person making the determination of necessity must be qualified. If the requirement in a particular area is that a doctor must make the determination, this task cannot be delegated to an assistant. The government will also examine how and if the person making the determination of necessity is compensated. If it is an unrelated individual, the government will examine whether there are improper payments, or kickbacks. If it is someone affiliated with the entity, the government will examine whether or not the professional is being paid fair market value and whether the compensation is based on the number of patients approved for treatment or revenue. Again, such compensation arrangements can be viewed as a kickback.

UPCODING

The government often examines whether a provider is consistently coding a more complex procedure, for which the reimbursement is higher, rather than a less complex version of that same procedure. This is called upcoding. It is critical that the documentation in the patient chart supports the level of service that is being provided. This is particularly true when a more complex procedure is being billed.

UNBUNDLING

Unbundling is where one procedure is split up and billed as a number of individual procedures to maximize reimbursement. For example, two procedures can be performed separately and are reimbursed at $100 each. However, when those two procedures are performed together, there is one billing code which pays $150. When those procedures are performed together, the third code must be used instead of "unbundling" those procedures and billing the two other codes separately in order to obtain higher reimbursement.

KICKBACKS

Kickbacks can be gifts or benefits to referral sources, beneficiaries, or employees. These are typically easier cases for the government to prove than cases that turn largely on expert testimony regarding complex medical procedures. It is good practice not to make any substantial gifts to referral sources or any gifts at all to beneficiaries, such as rebates or gift cards.

The government often takes the position that employee compensation based upon revenue is a kickback. While this may not seem as obvious as the conduct discussed in the previous paragraph, this is a risky practice and should ideally be discontinued.

In healthcare fraud investigations, the government usually examines a provider's marketing practices and will examine advertising and mailed materials. Providers need to ensure that their marketing professionals know what is appropriate in the healthcare field — what is generally accepted in many other industries may be illegal in the healthcare industry.

While the Federal Criminal Anti-Kickback Statute prohibits remuneration for referrals wholly or partially paid for by government funds, what most people do not realize is that the Texas law is much broader. The Texas Patients' Solicitation Act prohibits any remuneration for soliciting or securing a patient or patronage for or from a person licensed, certified, or registered by a state healthcare regulatory agency.

PROACTIVE MEASURES

Because of what is at stake, it is imperative that healthcare providers be very careful, particularly when working with the government. In addition to severe monetary sanctions, the government has the ability to require a provider to have a corporate monitor, place a monetary hold or suspend payments to a provider, exclude a provider from government programs, and even bring criminal charges against the provider. The collateral consequences from a government investigation may also implicate

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licensure issues with the State Board.

One of the most basic things a provider can do to minimize liability is to accurately chart. Often, because a provider is busy, the level of detail in patient records does not support what was billed. Patient treatment is only half the job; the other half is to accurately and adequately document the chart.

Providers and their staff must take the time to learn and follow the often complex rules. If an office is big enough, hire an in-house compliance officer. If not, find a competent consultant to advise you. You need to make sure you are following every procedure in order to minimize your liability if you find yourself in the government's sights.

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Comptroller certification, then the historic franchise tax rates applying in 2013 will apply again in 2015.

II. PERMANENT $1 MILLION EXEMPTION

For 2013, the Texas franchise tax law provided that taxable entities with total revenues not exceeding $1 million were not liable for any franchise tax. This $1 million threshold was scheduled to reduce to $600,000 for 2014, but H.B. 500 made the $1 million threshold permanent.

III. NEW $1 MILLION DEDUCTION

Previously, a taxable entity with total revenue of more than $1 million was taxed on the full amount of its total revenues. H.B. 500 provides that, beginning in 2014, a taxable entity will be taxed only on the excess of its total revenue above $1 million. This is accomplished by enabling a taxable entity to deduct $1 million from its total revenue in calculating its taxable margin.

IV. EXCLUSION OF FLOW-THROUGH FUNDS FOR CERTAIN INDUSTRIES

H.B. 500 includes provisions allowing certain taxpayers in the pharmacy, transportation and healthcare industries to exclude certain flow-through funds from their total revenues.

V. COST OF GOODS SOLD DEDUCTION

A. H.B. 500 includes a provision allowing certain oil and gas pipeline entities to include certain depreciation and costs of operations and maintenance in their cost of goods sold deduction.

B. H.B. 500 also specifies that movie theaters may include in cost of goods sold their costs of acquiring, producing, and exhibiting or using a film or motion picture, including their expenses for the right to use the film or motion picture.

VI. OTHER CHANGES

A. EXPANSION OF "RETAIL TRADE" DEFINITION

H.B. 500 expands the scope of companies potentially qualifying for the reduced franchise tax rate applying to retailers to include: auto-repair shops; companies selling goods under rent-to-own agreements; and companies renting or leasing tools, party and event supplies, furniture, or heavy equipment.

B. APPORTIONMENT

H.B. 500 provides that receipts from internet hosting are apportioned to Texas only if the customer is located within Texas.

C. RELOCATION TAX INCENTIVE

H.B. 500 allows certain companies who are relocating their home office or principal place of business to Texas from another state to deduct certain relocation costs from their apportioned margin. This deduction must be claimed on the company's initial Texas franchise tax report.

If you have any questions about how the newly enacted provisions of the Texas franchise tax might affect your clients, please contact Stephen Beck at 214-749-2401 or sbeck@meadowscollier.com.

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THE ALPHABET SOUP OF TREASURY: WHAT IN THE WORLD ARE BSA/AML EXAMS AND WHO ARE THE EXAMINERS?

BY MICHAEL A. VILLA, JR., J.D., LL.M.

If an Internal Revenue Service ("IRS") Agent knocks on your client's door, you might assume the IRS is conducting an audit of your client's tax returns. While this may be true of many IRS visits, it is not always the case.

The IRS has several different types of specialized agents, some of whom are not conducting Title 26 tax audits. Specifically, Bank Secrecy Act ("BSA") Examiners[1] are Revenue Agents who conduct Title 31 exams to determine if certain types of taxpayers are in compliance with the BSA and Anti-Money Laundering ("AML") laws.[2]

BSA EXAMINERS

For purposes of IRC § 6103, the BSA Examiner is an IRS Agent essentially working for Treasury, but not as an IRS employee, thus he or she cannot access tax returns or tax return information.[3] In addition to the Internal Revenue Manual ("IRM"), BSA Examiners have procedures for examining money service businesses that can be found in the BSA / AML Examination Manual, which is located on the Financial Crimes Enforcement Network ("FinCEN") website.[4]

In 2011, there were approximately 385 Title 31 Revenue Agents. BSA Examiners are responsible for, among other things: (1) examining non-bank financial institutions for BSA compliance, and (2) examining dealers of precious metals and stones, certain casinos, insurance companies, certain credit unions, and money service businesses. To the extent that the Examiner believes there are noncompliance issues, civil and criminal penalties may be applicable for noncompliance. Exams are conducted by experienced AML Agents identified as "SB/SE Fraud specialists."

FinCEN previously issued final rules requiring "dealers" in precious metals, jewels and stones to institute AML programs. The deadline to comply was January 1, 2006. During 2011, in order to ensure compliance, the IRS increased its efforts for Title 31 examinations of "dealers" engaged in the sale of "covered goods" (i.e. jewels, precious metals, precious stones [including finished goods]).[5]

Generally, a business will be deemed a "dealer" that is required to implement an AML program if: (a) the business buys more than $50,000 in covered goods; and (b) received more than $50,000 in gross proceeds from the sale of covered goods.[6]

GENERAL SCOPE AND DEPTH OF BSA EXAM

BSA exams focus on determining compliance with federal AML statutes and identifying areas of noncompliance with the BSA in business operations.[7] Practitioners should note that the BSA and related regulations at 31 CFR Part 103 are an entirely different group of laws from Title 26. Some procedures used in a BSA examination are substantially different from those used in an income tax examination.[8]

A recently received Information Document Request ("IDR") for a Title 31 examination reveals the type of information and records that Examiners are reviewing for compliance:

1. AML Program and Policy.
2. Any written policy statements or procedures as they relate to the BSA.
3. Training materials, training schedules and employee AML tests. Documents showing employees completed BSA training.
4. Installment sales agreements.
5. Customer records.
6. Bank statements.
7. Copies of Form 8300 which have been prepared.
8. Copies of Form 109 (SAR), FBARs, Form 105 (CMIR).
9. Company policies regarding payment arrangements.
10. Purchase records.
11. Identify suppliers and their background information.
12. If supplier is from another country, provide documentation verifying they are following AML procedures and regulations.
13. A list of nearby competitors who are dealers in Precious Metals, Stones or Jewels.

The BSA Exam should be sufficient to assure that the entity being examined is (a) subject to the BSA; (b) has a written AML compliance program that meets statutory and regulatory requirements; (c) is implementing a written AML compliance program that meets the statutory and regulatory requirements and that would identify structured transactions, trends and patterns of structuring, and other suspicious activities; and (d) is in compliance with all other applicable BSA recordkeeping and reporting requirements.[9]

DISTINCTIONS BETWEEN THE BSA EXAM AND A TITLE 26 AUDIT

If Examiners find violations, they may make civil penalty referrals to FinCEN and/or criminal referrals to IRS-Criminal Investigation ("CI").[10] However, if the Examiner finds a minor violation, such as unfiled BSA forms, then the Examiner may simply issue a BSA warning letter, also referred to as a Letter 1112.[11]

Practitioners should note that factors for civil penalty referrals are potentially broad.[12] In addition, although the Examiner is focused on issues related to BSA/AML compliance, the Examiner can refer the case for a Title 26 audit also.

There are several additional notable distinctions between a BSA exam and Title 26 audit. For example,

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the Examiner will request the practitioner to provide a general power of attorney valid under state law, not a Form 2848. IRS Form 2848 is not appropriate for BSA examinations.[13] Second, the Examiner may use the Title 31 summons instead of the income tax summons, Form 2039.[14] Third, the Examiner will likely seek interviews of person(s) responsible for compliance with the BSA, including compliance personnel, and business operations and management personnel.[15]

ISSUES FOR THE PRACTITIONER TO CONSIDER

The documents requested under the IDR or reviewed during the exam may show the Taxpayer failed to comply with the BSA/AML requirements.

Will the Examiner merely issue a Letter 1112 to correct mistakes? When is it appropriate for the Examiner to issue a Letter 1112, Notification of Apparent Violation? According to the IRM, Letter 1112 may be appropriate for violations that are technical, minor, infrequent, isolated or not substantive and do not meet the criteria for referral to FinCEN under the Referral Guidelines.[16] An example of Letter 1112 can be located in the IRM at Exhibit 4.26.8-2.

However, what if the violations are potentially more than minor? One must consider the possible consequences of a civil referral to FinCEN for penalties, or criminal referral to CI. In determining whether the violations might be more than "minor", it may be prudent to analyze whether the deficiencies will rise to the level of "willful" violations.[17] In addition, when reviewing the likelihood of referral, remember that factors for civil penalty referrals are potentially broad.[18]

Assuming there are significant or "willful" violations, a potentially critical issue to consider is the Examiner's request to interview the client. Of course, if the client refuses an interview, the examiner can obtain a summons. So the central issue may then become whether your client needs to consider, or at the very least understand, his right to invoke the privilege against self-incrimination.

If the client agrees to an interview, will he or she be making admissions that they failed to comply with AML regulations? Will this lead to other admissions regarding unreported income? Again, although this is not a Title 26 audit, the examiner will inevitably want to raise issues related to bookkeeping, which could begin to impact tax reporting issues. Admissions made by the client may potentially be subsequently admissible against him for purposes of civil penalties or criminal prosecution.

If you have any questions or would like additional information regarding IRS or BSA/AML exams, please contact Mr. Villa at mvilla@meadowscollier.com.

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[1] IRM 4.26.6 (BSA Examiner Responsibilities); IRM 4.26.8 (BSA Special Procedures).

[2] Please note this article provides a general overview of civil Title 31 BSA/AML exams; however, there is a separate and distinct group of IRS Criminal Investigation Agents who are assigned to a Bank Secrecy Act Task Force and who conduct criminal investigations pertaining to, but not limited to, Title 31 violations, such as currency reporting violations.

[3] IRM 4.26.6.1(3)

[4] http://www.fincen.gov/news_room/rp/files/MSB_Exam_Manual.pdf

[5] 31 C.F.R. § 1027.200.

[6] 31 C.F.R. § 1027.100. Note that the rules are broad and have limited exceptions, such as (i) retailers who purchase from dealers or other retailers, unless the retailer purchased more than $50,000 in covered goods from members of the general public or foreign sources of supply; or (ii) pawnbrokers, but only to the extent such person is engaged in pawn transactions. 31 C.F.R. § 1027.100(b)(2).

[7] IRM 4.26.6.1

[8] IRM 4.26.8.1(1)

[9] IRM 4.26.6.4.1.1

[10] IRM 4.26.8.4.3.

[11] IRM 4.26.8.4.1

[12] IRM Exh. 4.26.8-3.

[13] IRM 4.26.8.2.

[14] IRM 4.26.8.3(1).

[15] IRM 4.26.6.4.2.1(4).

[16] IRM 4.26.8.5.

[17] IRM 4.26.8.7

[18] IRM Ex. 4.26.8-3.

STATE CRIMINAL TAX PROSECUTIONS ON THE RISE

BY SARAH Q. WIRSKYE, J.D., CPA

Recent changes in the law have significantly broadened the conduct and increased the penalties for criminal state tax violations. Moreover, with the Comptroller's increased enforcement efforts in this area, businesses need to understand where they may have exposure and how to limit it.

What used to be a routine civil sales tax audit may now lead to a criminal prosecution. These cases have generally resulted in felony convictions. Examples of some of the prosecutions can be found at the State Comptroller website at www.window.state.tx.us/about/cid.

I. CHANGES IN THE LAW

Recordkeeping Requirements.

There have been significant amendments to require taxpayers to keep their records open for inspection for at least four years. Taxpayers must now produce contemporaneous records and supporting documentation for transactions in question to enable verification. There is also a new crime for failing to produce records to the Comptroller documenting a taxable sale of beer, wine, malt liquor, cigarettes, cigars, and tobacco products purchased using a resale certificate. These recordkeeping statutes have been used in many criminal cases.

Reporting Requirements.

House Bill 11 amended the Alcoholic Beverage Code and the Tax Code to require distributors and wholesalers who sell alcohol and tobacco products to Texas retailers to report those sales monthly to the Comptroller's office. The Comptroller's office reports that this new audit tool has helped identify more than $368 million due to the state since fiscal 2009 and there have been criminal referrals arising from House Bill 11 audits. This has been a highly controversial methodology because sales tax liability is being calculated based upon records from a third party, which may or may not be accurate. Moreover, these records do not consider case specific issues such as spillage, theft, or other matters. Finally, sometimes taxpayers have not been allowed access to the records until later in the process so it is very difficult to rebut the allegations.

Investigations.

There have also been changes that broaden the investigatory power of the Comptroller's Office. The subject matter jurisdiction of the Comptroller's investigators now includes investigation of any criminal offense under any law if the offense relates directly or indirectly to a tax, fee, penalty, or charge administered, collected, or enforced by the Comptroller. The Comptroller or Attorney General can also now use confidential tax information to enforce the criminal laws of Texas or the United States.

Litigation.

There have also been procedural changes that have been beneficial to the Comptroller. The state may request a judge make affirmative findings of tax fraud if the elements are proved by clear and convincing evidence during the proceedings. The statute of limitations may be tolled during the pendency of an indictment for a tax-related felony. Finally, statutory amendments make clear that there are no double jeopardy concerns which may relate from a civil penalty being pursued in an administrative action versus being pursued criminally.

Specific Crimes.

Penal Code amendments have broadened criminal statutes which affect criminal tax violations. Tax Code felonies were added to the list of crimes that may be prosecuted as Engaging in Organized Crime, resulting in a one degree punishment enhancement when groups of three or more collaborate together for the purpose of committing a tax felony. The definition of "Proceeds" in the criminal money laundering statute was amended to include proceeds acquired or derived from conduct that constitutes an offense under § 151.7032 of the Tax Code which is a first degree felony. Finally, the Tax Code was amended to make Criminal Conspiracy under the Penal Code applicable to Tax Code offenses.

Increased Penalties.

One of the most significant amendments regarding criminal sales tax is the change in the penalty ladder. The Tax Code was amended to bring tax crime penalties up to par with theft statutes. It is now a Class A or B misdemeanor, punishable by county jail time up to 180 days or 1 year, to collect and fail to remit sales tax between $50 and $1,500. Felony penalties, including prison time, will now begin at $1,500, just as they do in the Penal Code. Amounts over $200,000 will be classified as 1st degree felonies, punishable by 5-99 years or life in prison. Also, tax collected and not paid pursuant to one continuous scheme or course of conduct may be aggregated when determining the grade of the offense. Therefore, any sizable business with a criminal sales tax issue will likely be charged with a first degree felony.

II. CRITICAL AUDITS AND LIMITING A CLIENT'S EXPOSURE

There are generally two main factors that determine whether a criminal referral will be made in a civil audit. First, if there are taxes collected and not remitted, that is a red flag for the Comptroller's Office. Second, if there is a sizeable amount of tax due, the government may also refer the case criminally. However, most businesses will

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likely reach the unofficial monetary threshold because the Comptroller will usually be examining several years. Finally, any business who sells alcohol or tobacco should be on guard because of the emphasis on House Bill 11 audits and resulting criminal referrals.

If your client is in this situation, the audit must be handled with the understanding that a criminal referral may be made. Therefore, all statements by your client or documentary evidence given to the auditor must be monitored because they may be used in a criminal case. Also, if the client has the ability to pay the taxes, while that is not a pass on a criminal prosecution, the client should attempt do so.

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MEADOWS COLLIER 15TH ANNUAL TAXATION CONFERENCE

WILL BE HELD IN LATE OCTOBER 2013. DATE TO BE ANNOUNCED SOON. PLEASE WATCH FOR FURTHER INFORMATION TO BE POSTED ON THE FIRM'S WEBSITE AT WWW.MEADOWSCOLLIER.COM. HOPE TO SEE YOU THERE.

STATUTE OF LIMITATIONS PITFALLS: WHAT YOU NEED TO KNOW REGARDING THE IRS WAR ON THE TRADITIONAL THREE-YEAR STATUTE

BY LINDSAY A. HERMSEN, J.D., CPA

The Supreme Court's decision in *Home Concrete*[1] dealt with a key statute of limitations issue — whether the IRS could invoke the extended six-year statute of limitations in cases where the taxpayer underreported gain by overstating its reported basis. While the taxpayer victory in *Home Concrete* closed one door to the IRS, practitioners should be aware that numerous other provisions exist that can extend the statute beyond the general three-year period.

OVERVIEW OF *HOME CONCRETE*

The statute of limitations question presented to the Court in *Home Concrete* was whether an overstatement of basis extended the statute of limitations to six years under I.R.C. § 6501(e)(1)(A). The IRS asserted in numerous Son-of-BOSS tax shelter transaction cases that an overstatement of basis constituted a substantial omission from gross income, and thus, the six-year period applied. Because the three-year period had expired in many of those cases, the IRS stood to lose an estimated one billion in allegedly owed taxes[2] unless it successfully argued that the statute was nevertheless still open.

The Court held that the six-year period did not apply based on its 1958 ruling in *The Colony, Inc. v. Comm'r.*[3] In *Colony*, the Court held that an overstatement of basis did not fall under the omission from gross income provision of the 1939 Code, and thus the extended statute did not apply. The Government argued in *Home Concrete* that *Colony* was no longer controlling because the current provision arose out of the revised 1954 Code. By holding that *Colony's* precedential value remained intact, the Court rejected the Government's position that the six-year statute was applicable in overstatement of basis cases.

The *Home Concrete* decision represents a significant victory for taxpayers with pending overstatement of basis cases that should now be dismissed. But it also highlights the need to be aware of other tools the IRS could use to assess tax after the expiration of the three-year period.

EXCEPTIONS THAT EXTEND THE THREE-YEAR STATUTE

Section 6501 contains a number of exceptions that can extend the general statute of limitations beyond three years:

- § 6501(e)(1): Substantial Omission from Gross Income
- § 6501(c)(8): Failure to File Information Returns on Certain Foreign Transactions
- § 6501(c)(10): Failure to Disclose a Listed Transaction
- § 6501(h): Net Operating Loss Carrybacks
- § 6501(c)(7): Amended Returns

SUBSTANTIAL OMISSION FROM GROSS INCOME

The statute of limitations is extended to six years where the taxpayer omits more than 25 percent of "gross income" from the return. "Gross income" generally has the same meaning as in § 61, and we saw in *Home Concrete* that an overstatement of basis is not considered an omission from gross income for the purposes of triggering this extended statute. Although this provision received considerable attention in *Home Concrete* and other tax shelter cases, it is important to note that the extended statute is not limited to situations of "bad intent."[4]

Significantly, an *amended* return reporting the omitted amount will not avoid the six-year statute. On the other hand, a *superseding* return filed prior to the due date of the original return that reports the omitted income will keep the return within the three-year statute.

FAILURE TO FILE INFORMATION RETURNS ON CERTAIN FOREIGN TRANSACTIONS

Failure to file information required under the following sections will extend the statute of limitations to three years from the date the IRS receives the required information. Thus, if the information is never provided to the IRS, the statute remains open.

- § 1295(b): Form 8621 for PFIC to elect treatment as a qualified electing fund
- § 1298(f): Form 8621 for PFIC annual information report
- § 6038: Forms 5471/8865/8858 for foreign corporations, partnerships, and disregarded entities
- § 6038A: Form 5472 for foreign-owned corporations
- § 6038B: Forms 926/8865 for transfers to foreign persons
- § 6038D: Form 8938 for foreign financial assets
- § 6046: Form 5471 for an organization or reorganization of foreign corporations and acquisitions of stock
- § 6046A: Form 8865 for interests in foreign partnerships
- § 6048: Form 3520 for transactions involving foreign trusts

The 2010 HIRE Act modified § 6501(c)(8) such that a failure to satisfy the above reporting requirements triggers the extended statute for the ***entire*** tax return to which the information relates. There is a key exception however, such that if the failure to satisfy the reporting requirement is due to reasonable cause and not willful neglect, the extended statute will only apply to the items related to the reporting failure.

FAILURE TO DISCLOSE A LISTED TRANSACTION

Failure to include information required by § 6011 (Form 8886) with respect to a listed transaction will extend the statute until one year from the earlier of:

(A) the date the required information is furnished to the IRS, or

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(B) the date that a material advisor [*i.e.*, the promoter] complies with the IRS' request for the list the advisor is required to maintain with respect to the transaction.

The extended statute only applies to any tax resulting from the listed transaction. It was recently applied in *Bemont Investments, LLC v. United States*.[5] The district court ruled that the one-year additional period began to run when the IRS received a series of summons responses from the material advisor totaling over 2,000,000 pages.[6] The Fifth Circuit reversed and held that such a voluminous response did not satisfy the regulatory requirement that the IRS be able to locate the required information "without undue delay or difficulty,"[7] and therefore the statute remained open when the IRS issued its FPAA.

NET OPERATING LOSS CARRYBACKS

A net operating loss (NOL) carryback extends the statute for the year in which the loss is carried back to three years from the date of the return for the year giving rise to the NOL. Consider the following example:

- Company Y incurs an NOL for its tax year ended December 31, 2012, and with a return due date of March 15, 2013. Thus, the statute of limitations for the 2012 return expires on March 15, 2016.
- Company Y carries the NOL back to its 2010 tax year, which had a return due date of March 15, 2011. Absent the carryback, the statute of limitation for the 2010 return would have expired on March 15, 2014.
- However, because of the NOL carryback, the statute date for the 2010 return is now March 15, 2016 — the same as the statute date for the 2012 return that gave rise to the NOL.

The extension of the carryback year only applies to items related to the loss carryback. It does not allow the IRS to assess a deficiency on items unrelated to the carryback. Note that an agreement to extend the statute for the loss year will also extend the statute for the carryback year.

An interesting case arises if, under some other provision extending the statute for the carryback year, the carryback year is still open but the loss year is closed. In that situation, the Tax Court has held that it has the ability to look at the closed loss year so that it can determine the correct amount of NOL to be applied in the still-open carryback year.[8]

EXCEPTIONS THAT ELIMINATE THE STATUTE OF LIMITATIONS

In addition to the extension exceptions discussed above, Section 6501 includes the following exceptions under which there is ***no*** statute of limitations, which means that tax may be assessed at any time:

- § 6501(c)(1): False or Fraudulent Return
- § 6501(c)(2): Willful Attempt to Evade Tax
- § 6501(c)(3): Failure to File Return

The IRS bears the burden of proving that a taxpayer filed a fraudulent return or willfully attempted to evade tax. If the IRS is able to establish fraud as to *any* element of the return, the statute of limitations is eliminated for the *entire* return. A negligent or innocent failure to file will trigger the exception in § 6501(c)(3) — the failure need not be willful.

OTHER AREAS OF CONCERN

Finally, there are two situations for which practitioners may be concerned about the effect on the statute of limitations: amended returns and refund claims.

AMENDED RETURNS

An amended return that is filed within 60 days of the original statute closing date will extend the statute for 60 days from the date the IRS receives the amended return. In all other cases, where an amended return is filed before the 60 day period ending on the original statute date, it does not extend the statute.

REFUND CLAIMS

A refund claim does not extend or toll the statute of limitations. Where the right to refund is contingent on some future event that could occur after the period for making a refund claim has otherwise passed, a protective refund claim should be filed. A protective refund claim allows a taxpayer to preserve a potential right to refund of taxes previously paid, as illustrated in the following example:

- The IRS has challenged Taxpayer's deduction of an expense in Year 1.
- Taxpayer filed a petition in Tax Court for Year 1, which means the statute remains open for that year. But suppose the result of the Tax Court proceeding is that the deduction should have been taken in Year 2 — depending on when the Tax Court case concludes, the statute for Year 2 may have already closed. It would be too late for the Taxpayer to make a refund claim in Year 2, and Taxpayer would have also lost the deduction in Year 1.

cont. on p. 10

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- In this situation, Taxpayer should file a protective refund claim before the Year 2 statute closes, even though the issue of when the deduction should be taken is still undecided.

CONCLUSION

Although the taxpayers were victorious in *Home Concrete*, the IRS remains armed with numerous exceptions to the traditional three-year statute. Practitioners and taxpayers would be well-advised to seek counsel on these issues to avoid giving the IRS an undue extension of time to conduct a fishing expedition into the taxpayer's return.

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[1] *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2012).

[2] Alan Horowitz, *Opinion Analysis: No Six-Year Statute of Limitation on Overstatement of Basis*, SCOTUSBLOG (May 1, 2012, 11:33 AM), http://www.scotusblog.com/?p=144074.

[3] 357 U.S. 28 (1958).

[4] *See, e.g., Balice v. Comm'r*, T.C. Memo 2009-196; *Benson v. Comm'r*, 560 F.3d 1133 (2009).

[5] 679 F.3d 339 (5th Cir. 2012)

[6] *Id.* at 343–46.

[7] *Id.* at 346.

[8] *Calumet Industries, Inc. v. Comm'r*, 95 T.C. 257 (1990).

MORE TO COME? THE FEDERAL GOVERNMENT IS CURRENTLY CONSIDERING SEVERAL TAX REFORMS THAT WOULD CHANGE TAXATION OF BUSINESSES

BY STEPHEN A. BECK, J.D., LL.M.

The start of 2013 ushered in changes to the federal taxation of business and investment income. For example, the top marginal income tax rate applying to individuals (39.6%) is now higher than the top rate applying to corporations (35%). In addition, the maximum tax rate applying to qualified dividends and long-term capital gains is now 20%, increased from the previous 15% rate. A new 3.8% tax also potentially applies to net investment income, such as dividends and capital gains, earned by certain higher-income taxpayers. These changes and others have resulted in a new federal tax rate structure applying to taxpayers in 2013. A summary of this new rate structure applying to individuals is shown in **Figure 1** below.

Figure 1 – 2013 Individual Income Tax Rates

<table>
<tr><th></th><th>Taxable Income*</th><th>Ordinary Income</th><th>Capital Gains and Dividends</th><th>Medicare Tax on Earned Income**</th><th>Medicare Tax on Investment Income</th></tr>
<tr><td rowspan="8">Single Filers</td><td>$0+</td><td>10%</td><td rowspan="2">0%</td><td rowspan="5">2.9%</td><td rowspan="5">0%</td></tr>
<tr><td>$8,950+</td><td>15%</td></tr>
<tr><td>$36,250+</td><td>25%</td><td rowspan="5">15%</td></tr>
<tr><td>$87,850+</td><td>28%</td></tr>
<tr><td>$183,250+</td><td rowspan="2">33%</td></tr>
<tr><td>$200,000+ (AGI)</td><td rowspan="3">3.8%</td><td rowspan="3">3.8%</td></tr>
<tr><td>$398,350+</td><td>35%</td></tr>
<tr><td>$400,000+</td><td>39.6%</td><td>20%</td></tr>
<tr><td rowspan="8">Joint Filers</td><td>$0+</td><td>10%</td><td rowspan="2">0%</td><td rowspan="5">2.9%</td><td rowspan="5">0%</td></tr>
<tr><td>$17,900+</td><td>15%</td></tr>
<tr><td>$72,500+</td><td>25%</td><td rowspan="5">15%</td></tr>
<tr><td>$146,400+</td><td>28%</td></tr>
<tr><td>$223,050+</td><td rowspan="2">33%</td></tr>
<tr><td>$250,000+ (AGI)</td><td rowspan="3">3.8%</td><td rowspan="3">3.8%</td></tr>
<tr><td>$398,350+</td><td>35%</td></tr>
<tr><td>$450,000+</td><td>39.6%</td><td>20%</td></tr>
</table>

**Based on estimated 2013 inflation adjustments. Amounts refer to taxable income where noted. **Combined rate includes 1.45% employer contribution.*

cont. on p. 11

More to Come, cont. from p. 10

More changes may be on the horizon. As part of the current effort for broad tax reform, both the House Ways and Means Committee and Senate Finance Committee have recently issued written discussions of proposals for reforming the taxation of business income. It is unclear whether any of the proposals discussed by the Committees will be enacted, but they provide a "sneak peek" of the types of reforms that may be coming. The primary proposals contained in the Committee discussions are summarized below.

I. HOUSE WAYS AND MEANS COMMITTEE

A. GENERAL SMALL BUSINESS REFORMS

The House Committee's discussion draft on potential tax reforms, issued in March 2013, contained the following provisions applying to small businesses generally.

1. Code Section 179. Make permanent the ability of taxpayers to immediately deduct under I.R.C. § 179 investments in new equipment and property up to $250,000, with the deduction phased out for investments exceeding $800,000. (Without legislation, these amounts will revert to $25,000 and $200,000, respectively, in 2014.) Also, make permanent the current law provisions allowing computer software and certain investments in real property to qualify for I.R.C. § 179 expensing.

2. Cash Method of Accounting. Provide a uniform rule under which all businesses with gross receipts of $10 million or less may use the cash method of accounting. Also, generally exempt small businesses from rules requiring the capitalization of certain costs to their inventory.

3. Start-Up and Organization Expenses. Provide a uniform rule for deducting start-up and organizational expenses of all businesses, increasing the maximum initially-deductible amount to $10,000 (up from $5,000) with a phase out beginning at $60,000 (up from $50,000).

4. New Due Dates for Business Tax Returns. Provide the following generally applicable filing due dates: (i) March 15 for partnerships; (ii) March 31 for S corporations; and (iii) April 15 for C corporations and individuals.

B. PASS-THROUGH REFORMS

The House Committee's discussion also contained two options for reforming the federal income taxation of pass-through businesses.

1. Option 1. This option would involve separate revisions to Subchapters K and S, including the following.

   a. Changes Affecting S Corporations.

      i. Permanently reduce to five years (from ten years) the period following a conversion from C corporation status to S corporation status during which an S corporation must pay the I.R.C. § 1374 corporate tax upon the disposition of assets with pre-conversion built-in gains.

      ii. Increase to 60% (from 25%) the portion of an S corporation's income that may be passive without incurring an entity level tax, and eliminate the current rule that terminates an S corporation's pass-through status if it has excess passive income for three consecutive years.

      iii. Permit non-resident aliens to be S corporation shareholders through a U.S. electing small business trust.

   b. Changes Affecting Partnerships.

      i. Repeal the guaranteed payment rules, thereby treating all payments to partners as either payments in their capacity as partners (i.e., part of their allocable share of partnership income or loss) or in their capacity as non-partners.

      ii. Require mandatory adjustment of a partnership's basis in its assets upon a partnership distribution of property to a partner or a transfer by a partner of his interest in a partnership.

      iii. Clarify that all distributions of inventory items (i.e., not just substantially appreciated inventory) are treated as a sale or exchange between the partnership and partner under I.R.C. § 751(b).

      iv. Require that partners contributing property with built-in gains be subject to tax on the pre-contribution gains under I.R.C. § 704(c)(1)(B) and 737 when the partnership distributes that property at any time (i.e., not just within seven years of the contribution).

2. Option 2. This option would involve repealing the current Subchapters K and S and enacting a new uniform set of rules applying to non-publicly traded businesses, regardless of their state law form. The new rules would include the following.

   a. Contributions of property and money could be made on a tax-free basis.

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b. The pass-through of entity items of income, gain, loss and deduction would be maintained, and those items would have the same character in the hands of the owners that they have in the hands of the entity.

c. Only *net* ordinary income or loss, *net* capital gain or loss, and tax credits could be specially allocated among the owners.

d. Entity level withholding on the entity's income and gain would be required, and a corresponding credit would be provided for the owner's tax reporting.

e. All pass-through entities would be required to recognize gain on all distributions of built-in gain property, while losses in distributed built-in loss property would be preserved by requiring owners to take a carryover basis in that property.

f. Owners in all pass-through entities would be allowed to include entity level debt (both recourse and non-recourse) in their outside basis.

II. SENATE FINANCE COMMITTEE

The Senate Committee's discussion draft on potential tax reforms, issued in June 2013, contained several reform options grouped among the following categories.

A. DIFFERENT TYPES OF INCOME AND ENTITIES

1. Eliminate the Capital Gain Preference. Treat all or most types of income the same, while maintaining the two levels of tax on the earnings of a C corporation, by, for example, eliminating the capital gain preference and taxing capital gains and dividends as ordinary income.

2. Eliminate Double Taxation of Corporate Earnings. Fully integrate the corporate and individual income taxes through, for example, allowing corporations to deduct dividends paid to the extent that earnings were taxed at the corporate level.

3. Reduce Double Taxation of Corporate Earnings. Partially integrate the corporate and individual income taxes through, for example, adjusting the corporate and individual income tax rates so that the combined rate on corporate income and dividends is closer to the rate on pass-through business income.

4. "Redraw" the Line between C Corporations and Pass-Throughs. Adjust the number of entities whose income is subject to double taxation by, for example, requiring larger pass-throughs to pay tax as C corporations or allowing more businesses to pay tax on a pass-through basis.

5. Simplification. Simplify other rules relating to types of income and entities by, for example, conforming the rules for S corporations and partnerships.

B. CORPORATE FINANCE DECISIONS

1. Debt and Equity Parity. Create greater parity between debt and equity financing for C corporations through, for example, reducing the amount of interest payments that C corporations can deduct by 10%.

2. Distribution and Retention Parity. Create greater parity between retaining and distributing earnings for C corporations by, for example, lowering the tax rate applying to qualified dividends below the rate that applies to capital gains on C corporation stock.

C. COMPENSATION

1. Carried Interests. Reform the treatment of carried interests and other partnership interests received in whole or in part in exchange for services through, for example, taxing all partnership interests received in exchange for services as compensation rather than capital gains.

2. Self-Employment Income from S Corporations. Reform the treatment of S corporation income received in whole or in part in exchange for services through, for example, applying self-employment taxes to income of S corporations engaged in personal service businesses, such as health, law and accounting.

If you have any questions or would like any additional information regarding these reforms currently being considered by Congress, please contact Stephen Beck at 214-749-2401 or sbeck@meadowscollier.com.

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Dallas Bar Association Real Property Section
JOEL CROUCH
CONSERVATION AND FACADE EASEMENTS: ARE THEY FOR REAL OR A FACADE?

07.11.13 | AUSTIN
UT Law 2013 LLCs, LPs and Partnerships Conference
JOEL CROUCH & ALAN DAVIS
DYSFUNCTIONAL FAMILY LIMITED PARTNERSHIPS

07.16.13 | DALLAS
2013 Graduate Texas Trust School sponsored by the Wealth Management & Trust Division of the Texas Bankers Association
ALAN DAVIS
INCOME TAXATION OF ESTATES AND TRUSTS

08.02.13 | FORT WORTH
Fort Worth Chapter/ TSCPA Tax Institute
JOEL CROUCH
OFFERS IN COMPROMISE: IS THE IRS REALLY BECOMING KINDER AND GENTLER?

08.07.13 | SAN ANTONIO
39th Annual Advanced Family Law Course – TexasBarCLE
CHARLES PULMAN
COMMERCIAL TRANSACTIONS AND LEGAL ENTITIES PANEL PRESENTATION

08.14.13 | AMARILLO
Panhandle Chapter/ TSCPA Tax Institute
MATT BEARD
PARTNERSHIP FORMATION AND LIQUIDATION

08.16.13 | HOUSTON
State Bar of Texas Advanced Tax Law Course
MIKE VILLA
ETHICAL ISSUES ARISING IN DAY-TO-DAY TAX PRACTICE

08.23.13 | SAN ANTONIO
TSCPA 2013 Advanced Estate Planning Conference
TREY COUSINS
FRAUD OMISSIONS, ERRORS AND MISSED DEADLINES: DEALING WITH THE TROUBLED 706

09.27.13 | SAN ANTONIO
San Antonio Chapter/ TSCPA CE Symposium
DAVID COLMENERO
WHAT THE TEXAS LEGISLATURE GIVETH, TAXPAYERS AND TAX PRACTITIONERS CAN TAKE TO THE BANK

10.03-10.04.13 | NAPA, CA
New Frontiers in Marital Property 2013
CHARLES PULMAN (10.03)
TAXES AND DIVORCE
CHUCK MEADOWS (10.04)
CRIMES AFFECTING THE DIVORCE AND DIVISION OF THE MARITAL ESTATE

11.18.13 | AUSTIN
Austin Chapter/ TSCPA Annual Tax Conference
JOSH UNGERMAN
CIVIL AND CRIMINAL PENALTY/ EGGSHELL AUDITS

11.21.13 | SAN ANTONIO
TSCPA Tax Institute
TREY COUSINS
CURRENT AUDIT TRENDS
DAVID COLMENERO
TEXAS TAX FOLLOWING THE 2013 LEGISLATIVE SESSION: WHILE THE TEXAS LEGISLATURE GIVETH, CONGRESS MAY TAKETH AWAY

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11.22.13 | DALLAS

TSCPA Tax Institute

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CURRENT AUDIT TRENDS

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12.11-12.13 | NEW ORLEANS

Louisiana Society of CPAs Tax Conference

TREY COUSINS

SO YOU THOUGHT THE STATUTE OF LIMITATIONS WAS SIMPLE...

12.10.13 | SAN ANTONIO

TSCPA CPE Expo

JOEL CROUCH

WHAT TO EXPECT IN 2014 FROM A RAPIDLY CHANGING IRS

12.13.13 | ARLINGTON, TX

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ANTHONY DADDINO

WHAT TO EXPECT IN 2014 FROM A RAPIDLY CHANGING IRS

12.17.13 | HOUSTON

TSCPA CPE Expo

JOEL CROUCH

WHAT TO EXPECT IN 2014 FROM A RAPIDLY CHANGING IRS

THE FIRM CONGRATULATES CHUCK AND MATT FOR THE FOLLOWING ELECTIONS:

CHARLES M. MEADOWS, JR. HAS BEEN ELECTED AS A FELLOW OF THE AMERICAN COLLEGE OF TAX COUNSEL (ACTC).

MATTHEW S. BEARD HAS BEEN ELECTED TO MEMBERSHIP IN THE FELLOWS OF THE TEXAS BAR FOUNDATION.

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The Meadows Collier Newsletter is published by Meadows, Collier, Reed, Cousins, Crouch & Ungerman, L.L.P.; 901 Main Street; Suite 3700; Dallas, TX 75202. July-September 2013 edition.

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