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VOLUME 3

Important Changes to Payroll Taxes in Recent Legislation

By Todd A. Kraft, J.D., LL.M.

Under current law, the Social Security and Medicare payroll taxes apply only to "wages." For Social Security, employers and employees each pay 6.2% of wages, for a total tax of 12.4%. Self-employed people pay both halves of the tax, but they are allowed to deduct half of the tax, as though they were the employer withholding 6.2%. The tax stops once wages reach $106,800 for 2010. Regarding Medicare, each side pays 1.45%, for a total of 2.9%. However, there is no limit to the amount of wages subject to the Medicare tax.

Three new provisions were added in the HIRE Act, the Health Care Act, and the Reconciliation Act that affect these payroll taxes. One encourages hiring unemployed people, one increases the Medicare tax on wages, and the final expands the tax base to unearned income.

1. Encouraging Hiring New Workers

The HIRE Act provides a significant incentive to hire people who have been unemployed. All wages paid from March 18, 2010 (the date the HIRE Act became law) through December 31, 2010 are exempt from the employer portion of the Social Security tax. This provides a potential benefit of $6,621.60 to the employer ($106,800 x 6.2%).

continued on page 11

Estate Tax Lapse Affects Many Estate Plans

By Alan K. Davis, J.D., CPA

As you may be aware, Congress allowed the federal estate tax and federal generation-skipping transfer (GST) tax provisions to lapse on January 1, 2010. Ordinarily, this would be good news for taxpayers. However, the lapse of these provisions could have significant ramifications on many estate plans. Due to the federal estate tax and GST tax provisions being inapplicable during 2010, a death prior to the reinstatement of these taxes may materially affect how an estate plan operates. Specifically, the absence of these taxes may (i) cause assets to be distributed in a manner that was not intended or anticipated, and/or (ii) generate taxes that were not expected when the documents were executed.

Congress may, at some point during 2010 reinstate the estate and GST taxes. However, even if Congress reinstates these provisions retroactively, there may still be significant state law issues that will not be resolved. Alternatively, if Congress does not reinstate

continued on page 2

continued from page 1

these provisions during 2010, both taxes are reenacted automatically on January 1, 2011, but the exemption amounts and tax rates will revert to pre-2001 levels. The exemption amount will be reduced from $3.5 million (2009 exemption) to $1 million and the highest tax rate will increase to 55% from 45% (2009 rate). Therefore, estate planning to minimize estate and GST tax is still very important. It should also be noted that the federal gift tax is still fully applicable in 2010. Accordingly, lifetime transfers (or gifts) are still subject to the same gift tax rules that were applicable during 2009, except with a possible 35% tax rate.

As a result of these developments, there may be significant problems in any estate plan that uses a tax formula to allocate property. For example, a spouse could potentially be completely disinherited if an estate plan provided that an amount that can pass without estate tax went to children, and the balance will pass to the surviving spouse. If a decedent died when there was no estate tax applicable, the amount allocated to the children could be construed to be the entire estate, leaving nothing to pass to the surviving spouse. Another problem in many estate plans is outright dispositions to surviving spouses. If the first spouse dies when there is no estate tax and leaves his or her estate outright to the surviving spouse, a very bad result can ensue if (i) the estate tax is reinstated (as most anticipate) and (ii) the surviving spouse then dies when his or her estate is subject to estate tax. The point being that 100% of the estate tax on the first spouse's assets could have been avoided if those assets passed to a trust for the surviving spouse instead of outright.

A further problem is that a complex modified carry-over basis regime is applicable during this period of no estate tax. In a modified carry-over basis regime, an individual has two primary basis increase opportunities. The first is

a $1.3 million basis adjustment applicable to property passing to anyone. The second is a $3 million basis adjustment applicable only for property passing to a spouse or to marital trust for the spouse. Very few, if any, estate plans in existence today plan to maximize the use of these basis adjustments.

Yet another problem exists with respect to the treatment of a 2010 gift to an irrevocable trust with a zero inclusion ratio for GST purposes. Because there is no GST tax or GST tax exemption applicable for 2010, how such a transfer is to be treated is unknown. As many life insurance trusts are structured and administered to ensure that there is a zero inclusion for GST tax purposes, care must be exercised prior to any gifts to these trusts in 2010. Alternative ways to underwrite the insurance premiums, such as loans, should be considered especially if the amounts are significant.

Given these and other very significant issues, advisors and clients should immediately contact their estate planning attorneys for a review of the plan. This may result in a simple "patch" to address some of the issues raised above or an overhaul of the plan to address major problems. Alternatively, it could result in the client choosing not to take any actions until Congress acts and we know the final outcome.

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IRS Targets Independent Contractors

By Kathryn W. Lyles, J.D., LL.M.

The Internal Revenue Service (the "IRS") is increasing its focus on areas that will produce revenue. Employee/independent contractor misclassification is one such area of interest.

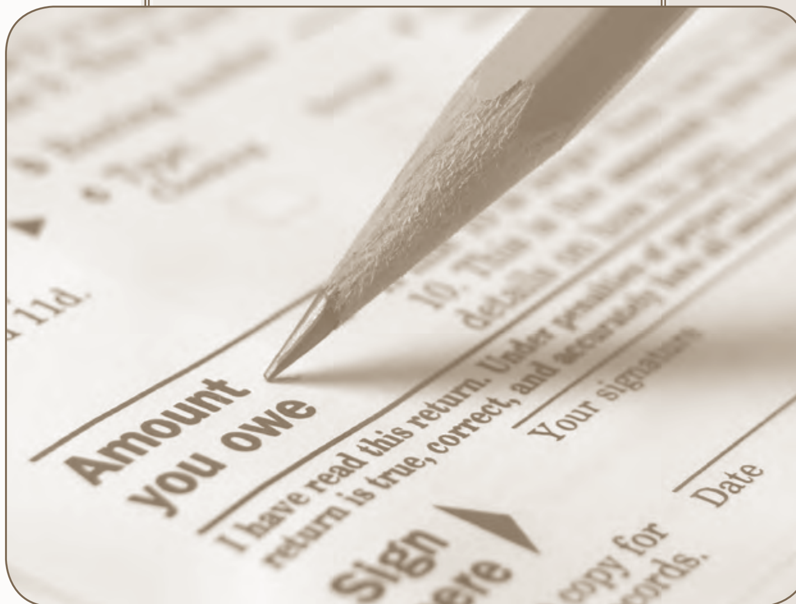
1. Dollars at Issue

In the last report produced by the IRS, which was in 1984, the IRS estimated that approximately 15 percent of employers misclassified employees as independent contractors, which resulted in over $1.6 billion of lost revenue (in 1984 dollars).[1] This report is obviously dated, but provides a perspective of the revenue dollars at issue. The IRS is currently in the process of completing a new report that will be available sometime in 2013. The new report will be based on a randomly selected group of employer tax returns from 2008 through 2010 and will estimate the number of employers that misclassify employees, the number of employees that are misclassified and the amount of tax dollars that are lost due to the misclassifications.[2]

2. IRS Enforcement Strategy

To identify employee misclassifications, the IRS relies on the following four sources: (1) The Determination of Worker Status Program (Form SS-8), (2) The Employment Tax Examination Program ("ETEP"), (3) general employment tax examinations, and (4) The Questionable Employment Tax Practices program ("QETP").[3]

The Form SS-8 serves as a streamlined procedure in which the employer or worker may request an IRS determination of employee/independent contractor status. The IRS also uses this program to identify employers that may have misclassified employees and therefore would be worthwhile to examine. In 2008, the IRS indicated that 72 percent of all Form SS-8 requests that it received resulted in IRS determinations that workers were employees[4].



The ETEP uses certain criteria to select employers that may have misclassified employees. The criteria include: employers that paid compensation to workers on Form 1099, the amount of compensation that workers reported on their tax returns, and the portion of the total workers compensation that was paid by the employers. Based on these criteria, the IRS selects employers with greatest potential for assessment.[5]

A majority of misclassification examinations result from the IRS examining an employer for a separate employment tax issue. All IRS employment tax examiners have received some amount of training in worker classification.

The QTEP is a relatively new program that was initiated in December of 2007. The program is a collaborative initiative between 34 state agencies (including the Texas Workforce Commission) and the IRS. Essentially, QTEP allows the IRS and state agencies to exchange information and leverage resources. As a result, an IRS employment tax audit involving a misclassification now typically results in a Texas Workforce Commission audit and vice versa.

As a result of the success of the QTEP initiative, it is likely that we will see an increase in collaboration between federal agencies and the IRS through future legislation. For example, the Senate and House of Representatives introduced bills in 2007 that would require the Department of Labor and the IRS to

continued on page 4

continued from page 3

share information in cases involving misclassifications.[6] Although neither of these bills passed, it is probable that similar bills will be reintroduced.

3. Targeting of Specific Industries

The IRS is also apparently targeting certain industries that have traditionally incorporated independent contractors into their business models. For example, Harvard University released a study that found that 14 percent of Maine construction firms misclassified workers as independent contractors.[7] Following the study, Maine state officials targeted the construction industry and found that 45 percent of the firms misclassified workers.[8] As a result, we expect to see similar targeting of specific industries where it is has been an industry practice to hire significant numbers of independent contractors, as is the case with the construction industry.

4. Consequences of Misclassification

There are significant consequences when the IRS reclassifies an independent contractor as an employee, and these consequences are not solely born by the employer. In fact, the IRS released a notice in August of 2009 outlining what workers should do in the event of reclassification.[9] Most importantly, the IRS Notice advised employees to file amended returns. In accordance with the amended return requirements, a reclassified employee will be required to report the compensation included on their Form 1099-MISC as wages on line 7 of their Form 1040. This will have a significant impact on the amount of tax owed by the reclassified employee. In addition, no FICA taxes would have been withheld from an independent contractor, so now the reclassified employee will have to compute the FICA taxes based on the employee's gross wages instead of computing self-employment tax on the net-income. Furthermore, previously claimed expenses that were reported on the reclassified employee's Schedule C must now be deducted as miscellaneous itemized deductions subject to disallowance equal to 2 percent of their adjusted gross income. Some of these expenses may no longer be deductible. Additionally, the reclassified employee will lose the deduction for one-half of his self-employment tax, as well as any other deduction allowed because of the reclassified employee's prior status as self-employed. Obviously, reclassification will significantly affect the tax liability of the reclassified employee.

On the other hand, the employer does not escape unscathed from a misclassification case. The most significant implication is the employer's liability with respect to federal income taxes that should have been withheld from the reclassified employee, as well as FICA and FUTA taxes. Moreover, going forward, the employer will be required to comply with federal withholding obligations.

In addition to the tax liability, the employer will also be required to provide certain benefits to the reclassified employee, such as workers compensation insurance and healthcare. Furthermore, the employer will now be subject to OSHA, The Family and Medical Leave Act, Immigration Reform and Control Act of 1986, COBRA and the Texas New Hire Reporting Requirements with respect to the reclassified employee, just to name a few. Therefore, it is no surprise that the reclassification of independent contractors to employees may easily force a company out of business.

5. Conclusion

We expect to see a growing number of misclassification cases as the IRS continues to focus on this area.

The financial impact of a reclassification of independent contractors to employees can have a major effect, especially if the misclassification involves a wholesale reclassification of an entire segment of a company's workforce. The consequences of such reclassifications will result in retroactive as well as prospective consequences to the business model. Employers must consider the overall effect of these reclassifications, rather than concentrating on a single issue that may be in front of them, e.g., unemployment insurance. These cases have the potential to develop into multi-issue/multi-agency audits, which generally result in a domino effect of adverse consequences.

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[1]GAO-09-717, p. 10
[2]GAO-09-717, p. 11
[3]GAO-09-717, p. 20
[4]GAO-09-717, p. 21
[5]GAO-09-717, p. 22-23
[6]S. 2044 & H.R. 5804
[7]GAO-09-717, p. 13
[8]GAO-09-717, p. 14
[9]IRS Notice 989 (August 12, 2009) ("Commonly Asked Questions When IRS Determines Your Worker Status is 'Employee'").

An Overview of Keller vs. United States

By Robert Don Collier, J.D., LL.M.
William R. Cousins III, J.D., LL.M., CPA
Todd A. Kraft, J.D., LL.M.

The Firm was pleased to represent an estate in a large estate tax case with a favorable outcome for the taxpayer. The opinion was issued on August 20, 2009, by Judge John D. Rainey, United States District Court, Southern District of Texas, Victoria Division. *See Keller v. United States*, 104 A.F.T.R.2d 2009-6015. The opinion followed a four-day non-jury trial and numerous pre-trial and post-trial briefs by the Estate and the Government.

The Decedent was Maude O'Connor Williams ("Mrs. Williams"), who died on May 15, 2000 at the age of 90. Mrs. Williams' husband predeceased her in 1999.

Following his death, a plan was developed to establish a Limited Partnership to be owned 49.95 percent as a limited partner by Mrs. Williams' revocable trust ("Trust A"), a second 49.95 percent as a limited partner to be owned by an irrevocable marital deduction trust to be funded by her husband's estate ("Trust M"), and 0.1 percent by a corporate general partner ("the General Partner"). Mrs. Williams was the sole Trustee of Trust A and Trust M.

Mrs. Williams was also to be the initial shareholder of the General Partner, but it had been orally agreed that she would immediately sell her shares, 50% to her daughter ("Ann Harithas") and 25% to each of her two grandsons from a deceased daughter ("Michael Anderson" and "Steve Anderson").

The Limited Partnership was to be funded with approximately $250,000,000 of Community Property Bonds from Trust

A and Trust M held in a Vanguard, and the General Partner was to be funded with $300,000 cash, a portion of which was to be used to make a contribution to the Limited Partnership for the general partner interest.

Status of Documentation of the Limited Partnerships Before Death

On May 9, 2000, Mrs. Williams was in the hospital, but her physicians did not believe that her death was imminent. For approximately two hours that evening, Lane Keller, one of the Family Accountants, met with her, reviewing in detail the final drafts of the Limited Partnership's and General Partner's organizational documents. Mrs. Williams then signed the organizational documents multiple times in her various capacities as Trustee of both Trust A and Trust B and as President and Director of the General Partner.

At that time, there was no written assignment of the Community Property Bonds to the Limited Partnership or the cash to the General Partner. An exhibit to the Limited Partnership Agreement setting forth the dollar value of the capital contributions of each Partner was also left blank. There was also no formal written agreement evidencing Mrs. Williams' agreement to sell the stock in the General Partner to her daughter and two grandsons.

Status of Partnership Following Death

Mrs. Williams died unexpectedly, six days later on May 15, 2000. The Family Accountants had taken various actions to finalize the entities after the May 9, 2000, document executions, including the necessary filings with the Texas Secretary of State's Office. Nevertheless, there was still no formal assignment of the Community Property Bonds on the date of Mrs. Williams' death. A $300,000 check had been drafted for the capital contribution to the General Partner, but it had not been signed by Mrs. Williams. There was also still no written agreement for the sale of her shares in the General Partner.

continued on page 6

continued from page 5

Since there were no effective written documents transferring the Community Property Bonds and the $300,000 of cash, Mrs. Williams' advisors ceased all activity on the entity formations following her death. Further, on the due date of the federal estate tax nine months later, estate tax of $147,800,245 was paid to the IRS with the extension, which amount was calculated on the basis of the Limited Partnership not being effective.

Advisors Realize They Might Have a Partnership

On May 17, 2001, however, one of the Family Accountants attended an estate planning seminar in Victoria where the then recent case of *Church vs. United States*, 2000 WL 206374 (W.D. Tex. Jan. 18, 2000), was discussed. On the basis that *Church* might support that Mrs. Williams' Limited Partnership had been in fact funded, the family advisors then completed all of the formalities for the funding of the Limited Partnership, the General Partner and the sale of the shares of the General Partner. The prior use of $114,000,000 of the Limited Partnership Community Property Bonds to pay estate tax was also documented as a loan by the Limited Partnership to the Estate.

Thereafter, the federal estate tax return was filed without claiming any discounts for the Limited Partnership interests, which was promptly followed by a refund claim based on substantial discounts. When the IRS failed to act on the refund claim, the Estate filed suit in Federal District Court.

The Trial

The four day trial presented numerous witnesses and written documentation aimed at establishing the following major issues, as well as the deductibility of various administrative expenses: (i) That Mrs. Williams intended the Community Property Bonds to be partnership property upon the signing of the organizational documents on May 9, 2000; (ii) That Mrs. Williams similarly intended the General Partner to be capitalized with $300,000.00 and that she had a binding agreement to sell the shares in the General Partner to her daughter and two grandsons; (iii) That each assignee Limited Partnership interest had a fair market value that was discounted by approximately 47.5% of the asset value of the Limited Partnership; and (iv) That the formation of the Limited Partnership met the bona fide sale requirements of *Kimbell vs. U.S.*, 371 F.2d 257 (5th Cir. 2004), for the avoidance of Sections 2036 and 2038.

Highlights of the Court's Findings and Conclusions

The Court's opinion is 38 pages long, containing very detailed findings of fact and conclusions of law. The major highlights from the Court's findings and conclusions are as follows:

(i) Ownership Of Bonds:

"Despite the fact that Mrs. Williams passed away before certain formalities were observed, the Court finds it clear that, at the time her death, she intended the Community Property Bonds to be Partnership property… Mrs. Williams, as trustee of Trust A and Trust M, and as the initial sole owner of the general partner, represented all of the partners, and therefore her intent was the intent of all the partners at the time of the Partnership's formation."

"Pursuant to Texas law, and as discussed below, the Court finds that the Community Property Bonds were Partner-

continued on page 7

continued from page 6

ship property…Well-established principles of Texas law provide that the intent of an owner to make an asset partnership property will cause the asset to be property of the partnership. *Church v. United States*, No. SA-97-CA-0774-OG, 2000 WL 206374, at *7 (W.D. Tex. Jan. 18, 2000); *Biggs v. First Nat'l Bank of Lubbock*, 808 S.W. 2d 232, 237 (Tex. App.—El Paso 1991, writ denied); *King v. Evans*, 791 S.W. 2d 531, 532 (Tex. App.—San Antonio 1990, writ denied); *Logan v. Logan*, 156 S.W. 2d 507, 512 (Tex. 1941)."

(ii) Capitalization Of General Partner And Agreement To Sell:

"Similarly, the Court finds that, at the time of her passing, Mrs. Williams intended that the corporate general partner be capitalized with the $300,000 check cut by Lane Keller and agreed to sell the stock in the general partner to Ann Harithas, Michael Anderson, and Steve Anderson."

"In accordance with Texas law, this agreement was enforceable because, among other things, the executors of Mrs. Williams' estate had a duty to complete the transactions surrounding the general partner's formation…. Moreover, Mrs. Williams was obligated to fund the general partner and assign her stock to Ann Harithas, Michael Anderson, and Steve Anderson. *See* TEX. BUS. & COM. CODE ANN. §8.113; *Neyland v. Brammer*, 73 S.W. 2d 884, 888 (Tex. Civ. App.—Galveston 1993); *see also Cardwell v. Sicola-Cardwell*, 978 S.W. 2d 722, 726 (Tex. Civ. App.—Austin 1998) ('[C]ontractual obligations generally survive the death of a party and bind his estate if the contract is capable of being performed by the estate representatives.')."

(iii) Fair Market Value of Partnership:

The Court adopted the taxpayers' valuation expert and disregarded the government's. "The Court finds that the Plaintiffs' expert, Mr. Robert Reilly, used the correct standard in determining the fair market value of Mrs. Williams' interests at the date of her death. The Government's expert, Dr. Alan Shapiro, violated several of the tenets of the hypothetical buyer and seller standard, including considering the true identities of the buyer and seller, speculating as to events occurring after the valuation date, and aggregating the interests of different owners."

"Crediting the testimony of Mr. Reilly, and disregarding that of Dr. Shapiro, and in light of the hypothetical buyer and seller standard applicable to this case, the fair market value of the Partnership's assets, of the date of Mrs. Williams' death, was $261,042,664…The Court further finds that the fair market value of Trust A and Trust M's assignee interests in the Partnership was $68,439,000 each."

(iv) 2036/2038:

Section 2036 and Section 2038 do not apply in the case of a bona fide sale for adequate and full consideration. The tests for determining the applicability of the exception in the Fifth Circuit were established in *Kimbell*. Per *Kimbell*, the Court concluded as follows:

[1]Bona Fide Sale.

(a) Protection of Family Assets vs. Incidental Estate Tax Savings. "It is clear to the Court that the primary purpose of these partnerships was to consolidate and protect family assets for management purposes and to make it easier for these assets to pass from generation to generation. Any estate tax savings that resulted from these partnerships were, in the Court's view, merely incidental. It is, therefore, clear to the Court that the primary purpose of these part-

continued on page 8

continued from page 7

nerships was not federal estate tax avoidance, and the actions taken to form these partnerships were not done so to create a disguised gift or sham transaction as those terms are used in estate taxation."

(b) Real, Actual, Genuine and Not Feigned. "Mrs. Williams' transfer of the Community Property bonds to the Partnership was a bona fide sale. First, the lengthy discussions that went into creating the Partnership Agreement, which Mrs. Williams signed, provide sufficient objective evidence that the Partnership transaction was "real, actual, genuine, and not feigned." *Kimbell*, 371 F.3d at 263.

(c) Protection From Ex-Spouses. "Second, the primary purpose underlying the Partnership's formation was to protect family assets from depletion by ex-spouses through divorce proceedings. This was accomplished by creating an entity that, by altering the legal relationship between Mrs. Williams and her heirs, could facilitate the administration of significant family assets. In other words, the creation and funding of the Partnership was undertaken for a legitimate business purpose and not the mere 'recycling' of wealth."

(d) Outside Assets. "Finally, the fact that Mrs. Williams had a significant collection of assets outside of the Partnership—well over $100 million—further supports the conclusion that the transfer was made pursuant to a bona fide sale."

[2] Adequate and Full Consideration.

"Mrs. Williams' transfer was made for full and adequate consideration. First, the 'Subscription and Acceptance by Limited Partner' portion of the Partnership Agreement provides that the percentage

interests of the partners are proportionate to their respective contributions. The Agreement also sets forth the capital accounts in which the contributions of a partner are credited to the respective capital account of the partner. Finally, the Partnership agreement provides that, upon liquidation, the partners are to receive their capital accounts in accordance with their percentage interests."

Evidentiary Issues. The Government attempted to exclude much of the Estate's oral evidence on the basis of such exclusionary evidence rules as various parol evidence rules, hearsay rules and the Texas "Dead Man's Rule." On the basis of numerous exceptions or the limited scope of such rules, the Court rejected all of the Government's attempts.

Interest on Limited Partnership Loan. The Court also held that the interest on the $114,000,000 loan by the Limited Partnership to the Estate to pay estate taxes was a deductible administrative expense on the basis that the Estate lacked sufficient liquid assets to pay its necessary taxes and obligations.

Limited Comment. As an appeal of this case by the Government is a possibility, we have restricted this article to a review of the Opinion without commentary.

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continued on page 9

continued from page 8

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IRS Wealth Squad – Holistic Taxpayer Analysis

By Josh O. Ungerman, J.D., CPA

The Internal Revenue Service rolled out a new unit within the large and mid-size business (LMSB) division. The new unit is called the LMSB Global High Wealth Industry Group a/k/a the "IRS Wealth Squad." The goal of the IRS Wealth Squad is to move from a historical stove-pipe analysis of a single taxpayer return into an evolved and holistic analysis of all facets of a taxpayer's business life, including charitable, estate, gift and income tax matters.

The IRS copied this concept from taxing authorities in Japan, Germany, the UK, Canada and Australia. Through the IRS Wealth Squad, the IRS will build new risk assessment techniques to identify high-income and high-wealth individuals that will be reviewed on a holistic basis along with their related enterprises. The IRS has finally come to the conclusion that they cannot assess compliance among the nation's wealthiest taxpayers by looking only at a Form 1040 Individual Income Tax Return.

The IRS is also giving up its smoke-stack mentality of approaching each tax return in the enterprise as a single and separate entity. Instead, the holistic approach will scrutinize the entire economic picture of the enterprise controlled by wealthy taxpayers to assess overall tax compliance.

Who is the IRS going to go after first? Initially, the IRS will be looking at taxpayers with tens of millions of dollars in assets or income. The IRS is focused on these wealthy taxpayers, who the IRS believes have "a myriad of holdings and sources of income beyond the obvious ones." As with most recent IRS initiatives, international components will become a definite area of focus. However, domestic matters in the areas of income, estate and gift taxes will also be subject to the reach of the new IRS Wealth Squad.

continued on page 10

continued from page 9

The IRS has stated that it intends to conduct an extensive interconnected and flow-through analysis. Practically, the IRS Wealth Squad is expected to initially approach family offices and ask for an organizational chart. It is very important that taxpayers carefully review their organizational charts with regard to large family wealth structures to ensure that they accurately reflect the entire organization. Additionally, family offices should segregate privileged and work-product documents. Obviously, waiver is a key issue in this area.

The IRS Wealth Squad will focus on the tax consequences of sophisticated financial business and investment arrangements with complex legal structures. While it is comforting to know that the IRS considers many sophisticated arrangements to be entirely tax compliant, it is concerning that the IRS, from the outset, has expressed concern that other arrangements "mask aggressive tax strategies." A big question is: Where exactly will the IRS Wealth Squad draw the line between these two worlds? The IRS Wealth Squad defines complex financial arrangements as trusts, real estate investments, royalty and licensing agreements, revenue-based or equity-sharing arrangements, privately-held companies and private foundations. Accordingly, even charitable activities will be scrutinized.

The IRS Wealth Squad will look closely at partnerships and other flow-through entities. According to the IRS, it will look for actual or "beneficial ownership" of numerous related entities either solely at the taxpayer level or more holistically by including other family members and business associates in the process. Taxpayers subject to the long arm of the IRS Wealth Squad may wish that they were actually in an old-fashioned taxpayer compliance audit rather than an IRS Wealth Squad holistic audit.

The IRS plans to staff the IRS Wealth Squad with hundreds of new agents. Examination agents and individuals with specialized skills and experience will be hired. The team will include economists to identify economic trends and appraisal experts to advise on valuation issues. Furthermore, technical advisors will provide industry or specialized tax expertise while the old standbys of flow-through specialists and international examiners will also be included.

A concern exists among practitioners that the IRS Wealth Squad's holistic approach will actually morph into an economic-substance analysis for transactions that provide a tax benefit. Additionally, it would not be surprising if the IRS aggressively begins using Internal Revenue Code Section 482 transfer-pricing techniques to disallow tax benefits. Finally, on the penalty front, an optimistic view is that the holistic taxpayer analysis of the IRS Wealth Squad will result in a mature dialogue regarding the potential application of penalties. This trend would be much welcomed as opposed to the behavior the IRS has recently exhibited regarding penalties in complicated tax structures. Specifically, the rejection of a reasonable-cause defense based on reliance upon tax professionals when the IRS does not like the transaction or thinks that the taxpayer should have known a particular transaction "was too good to be true" has been an unsettling trend. In any event, participation in a holistic IRS audit will definitely be both interesting and challenging.

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continued from page 1

To qualify, the new employee must have worked no more than 40 hours during the 60 days preceding the hiring date. The employee must start work after February 3, 2010 and before January 1, 2011. Other requirements also exist to prevent gamming the system. For instance, the employee cannot be a relative, and the employer cannot fire someone without cause and replace them with an unemployed person. Oddly, however, spouses are not considered related persons for this purpose. Finally, the employee must sign the new Form W-11 under penalties of perjury attesting that they have not worked more than 40 hours in the last 60 days.

Furthermore, if the employee stays employed for 52 consecutive weeks, the employer can claim a credit on its 2011 return of up to $1,000. The credit is the lesser of 6.2% of wages paid during the 52 weeks or $1,000.

2. Increase Tax On Wages

Beginning in 2013, wages will be subject to an additional 0.9% Medicare payroll tax, for a total of 2.35% for the employee side of the tax, provided the employee reaches certain income thresholds. The additional tax is imposed on married couples who have wages in excess of $250,000, single people with wages in excess of $200,000, and married people filing separately who have wages of $125,000. These threshold amounts are not indexed for inflation. Employers continue to pay 1.45%, and self-employed taxpayers pay 3.8%.

The new tax is borne entirely by the employee – there is no employer half. Nonetheless, the employer will withhold the tax on behalf of the employee. If there has been an over-withholding or under-withholding, the employee will make up the difference or receive a refund with his or her income tax return. Fortunately, the IRS has over two years to figure out how that will work.

3. Medicare Tax Imposed on Net Investment Income

The Reconciliation Act signed March 30, 2010, brought a more dramatic change. Under the same thresholds as above, the Act imposes a 3.8% Medicare tax on net investment income. The bill defines net investment income as interest, dividends, annuities, royalties, rents, taxable net capital gains, and income derived from a passive activity within the meaning of Section 469. It excludes distributions from a qualified annuity or pension plan. Investment income is also reduced by deductions which are properly allocated to the production of such investment income. This tax becomes effective in 2013.

The new tax applies only to total income in excess of the thresholds. So, for example, if a couple earns $200,000 in wages and has a capital gain of $100,000, only $50,000 of the capital gain is subject to the Medicare tax.

By the effective year of 2013, the "Bush" tax cuts of 2001 presumably will have sunset and not have been extended. Or so the President's 2011 budget presumes. The top marginal rate for ordinary income, such as interest will then be 39.6% income tax plus 3.8% Medicare tax, or 43.4%. The top capital gain rate – again, if the President's budget becomes law – will be the sum of 20% and 3.8%, or 23.8%.

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MAY 4, 2010 — CHUCK MEADOWS, TOM HINEMAN, JOSH UNGERMAN, DAVID COLMENERO

Dallas CPA Society Free CPE Day 2010
Meadows – *"Aggressive Tax Planning, Unethical Conduct or Tax Fraud",*
Hineman – *"Planning Opportunities for Financially Distressed Entities and Related Issues",*
Ungerman – *"Foreign Account Disclosure and Reporting Issues",*
Colmenero – *"Representing Your Clients Before the Texas Comptroller of Public Accounts"*
Dallas, TX

MAY 4, 2010 — TREY COUSINS

AICPA Conference on Tax Strategies for the High Income Individual
"How CPA's Get in Trouble"
Las Vegas, NV

MAY 6, 2010 — TREY COUSINS

Midland Memorial Hospital Foundation and the Midland College Foundation 13th Annual Estate Planning Update Seminar
"Litigating FLP's: The Keller Decision"
Midland, TX

MAY 6, 2010 — ALAN DAVIS

Austin Financial Planning Association
"No Estate Tax – Now What?"
Austin, TX

MAY 7, 2010 — TREY COUSINS

DFW Financial Planning Association
"Transfer Tax Litigation Issues After The Dust Clears"
Dallas, TX

MAY 12, 2010 — TREY COUSINS, ALAN DAVIS, JOSH UNGERMAN, TODD KRAFT

Texas Bank and Trust Seminar
Cousins – *"Transfer Tax Litigation and the Keller Decision",*
Davis – *"No Estate Tax – Now What?",*
Ungerman – *"Evolution of an IRS Fraud Case",*
Kraft – *"Paying for Healthcare: Tax Provisions in the Healthcare Legislation"*
Tyler, TX

MAY 14, 2010 — TREY COUSINS

Professional Advisor Day hosted by the Office of Gift Planning at The University of Texas at Austin
"Aggressive Estate Planning without the Necessity of IRS Litigation"
Austin, TX

MAY 14, 2010 — ANTHONY DADDINO

North American Petroleum Accounting Conference
"TBA"
Dallas, TX

MAY 19, 2010 — TREY COUSINS

Farm and Ranch Accounting & Tax Update
Accounting Continuing Professional Education Network (ACPEN) Broadcast
"Estate Planning Issues for Farmers and Ranchers"
Dallas, TX

MAY 19, 2010 — JOEL CROUCH

San Angelo Chapter/TSCPA
"Circular 230"
San Angelo, TX

MAY 20, 2010 — CHUCK MEADOWS, JOEL CROUCH, TODD KRAFT, DAVID COLMENERO

Central Texas Chapter/TSCPA CPE Expo
Meadows – *"Difference Between Aggressive Tax Planning and Fraud",*
Crouch – *"Tax Disputes Before the IRS: Audit, Appeal and Tax Litigation",*
Kraft – *"Paying for Healthcare: Tax Provisions in the Healthcare Legislation",*
Colmenero – *"The Texas Franchise Tax: What the Texas Comptroller and the Texas Legislature Have in Mind"*
Waco, TX

continued from page 11

MAY 24, 2010 — TODD KRAFT, DAVID COLMENERO, ANTHONY DADDINO

East Texas Chapter/
TSCPA CPE Expo
Kraft – *"Paying for Healthcare: Tax Provisions in the Healthcare Legislation",*
Colmenero – *"The Texas Franchise Tax: What the Texas Comptroller and the Texas Legislature Have in Mind For You and Your Clients",*
Daddino – *"Circular 230 and the Section 6694 Penalty Regime – The Answer to Such Questions as What's Causing My Anxiety Attacks? Why is Malpractice Insurance Increasing? Should I Retire? and Many Others"*
Tyler, TX

MAY 25, 2010 — CHUCK MEADOWS, ALAN DAVIS, DAVID COLMENERO

Wichita Falls Chapter/
TSCPA
Meadows – *"Tax Planning vs. Tax Evasion",*
Davis – *"No Estate Tax – Now What?",*
Colmenero – *"Representing Clients Before the Texas Comptroller of Public Accounts"*
Wichita Falls, TX

MAY 26, 2010 — TREY COUSINS, ALAN DAVIS, JOSH UNGERMAN, TODD KRAFT

Texas Bank and Trust
Seminar
Cousins – *"Transfer Tax Litigation and the Keller Decision",*
Davis – *"No Estate Tax – Now What?",*
Ungerman – *"Evolution of an IRS Fraud Case",*
Kraft – *"Paying for Healthcare: Tax Provisions in the Healthcare Legislation"*
Longview, TX

MAY 26, 2010 — JOEL CROUCH

Fort Worth Chapter – American Society of Women Accountants
"Current Trends in IRS Examinations and Appeals"
Fort Worth, TX

JULY 23, 2010 — TREY COUSINS

2010 UT LLCs and Partnerships Conference
"Family Limited Partnerships: Where Are We Now?"
Austin, TX

AUGUST 6, 2010 — TREY COUSINS

Fort Worth CPA Tax Institute sponsored by the Fort Worth Chapter/TSCPA
"IRS Collection Activity"
Fort Worth, TX

AUGUST 12, 2010 — TREY COUSINS, SARAH WIRSKYE

San Antonio
Chapter/TSCPA
CE Symposium
Cousins – *"Civil Tax Litigation"*
Wirskye – *"Criminal Tax"*
San Antonio, TX

AUGUST 20, 2010 — TREY COUSINS

TSCPA's Advanced Estate Planning Conference
"Keeping Estate Planners Out of Trouble"
San Antonio, TX

AUGUST 25, 2010 — THOMAS (TOM) HINEMAN, CHARLES PULMAN, TODD KRAFT & STEPHEN (STEVE) BECK

Panhandle Chapter/
TSCPA Tax Institute
Hineman – *"Tax Planning for Financially Distressed Partnerships",*
Pulman – *"Divorce and Separation: A Taxing Experience",*
Kraft & Beck – *"Federal Income Tax Update"*
Amarillo, TX

AUGUST 26, 2010 — JOSH UNGERMAN

State Bar of Texas – 28th Annual Advanced Tax Course
"Hot IRS Topics"
Dallas, TX

SEPTEMBER 16, 2010 — ALAN DAVIS

Victoria Area Estate Planning Council
"TBA"
Victoria, TX

OCTOBER 21, 2010 — JOEL CROUCH & ANTHONY DADDINO

MIGI Conference sponsored by the Panhandle Chapter/TSCPA
"Employment Tax Law"
Amarillo, TX

DECEMBER 16, 2010
DECEMBER 17, 2010 — TREY COUSINS

Louisiana Tax Conference sponsored by the Louisiana Society of CPAs
"TBA"
New Orleans, LA

Meadows, Collier, Reed, Cousins, Crouch & Ungerman, L.L.P.

wishes to congratulate

ANTHONY P. DADDINO

on being named a Partner in the firm.

Mr. Daddino's practice is focused on representing individuals, estates, partnerships, closely-held businesses, and large corporations in all stages of tax disputes, including IRS examinations, administrative appeals, and litigation in U.S. Tax Court, U.S. District Court, and the U.S. Court of Federal Claims. He also represents tax practitioners in disciplinary matters before the IRS's Office of Professional Responsibility. Mr. Daddino attended Southern Methodist University, where he received his B.B.A. (magna cum laude) and J.D. (cum laude) and was a member of the Order of the Coif. Mr. Daddino is an adjunct law professor at S.M.U. Dedman School of Law, where he teaches Corporate Income Taxation.

Email: adaddino@meadowscollier.com

12th Annual
Meadows Collier Taxation Conference

October 2010

WATCH FOR DATE, SPEAKERS AND TOPICS!

Meadows, Collier, Reed, Cousins, Crouch & Ungerman, L.L.P.

wishes to congratulate the following firm attorneys:

- **Stephen A. Beck** upon becoming Board Certified in Tax Law by the Texas Board of Legal Specialization.
  Email: sbeck@meadowscollier.com

- **Joel N. Crouch** for being elected to membership in the Fellows of the Dallas Bar Foundation.
  Email: jcrouch@meadowscollier.com

- **Anthony P. Daddino** and **Michael A. Villa, Jr.** for being named 2010 Texas Rising Stars, as published in *Texas Monthly* and in *Texas Super Lawyers – Rising Stars Edition*, and on the web at *superlawyers.com.*
  Email: adaddino@meadowscollier.com
  Email: mvilla@meadowscollier.com

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**Board Certified in Commercial Real Estate Law
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