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New IRS Exam Techniques — IRS Audits 1 Out of Every 8 Millionaires

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

Background

The IRS has finally done it. The massive tax agency has finally shifted from low and middle income taxpayers with little ability to pay a huge assessment to those U.S. taxpayers, who can easily, though begrudgingly, write a big check to Uncle Sam.

The high exam coverage of America's most wealthy is not an accident. It is part of a concerted effort by the IRS

to follow the advice it received from one of the largest consulting groups in the U.S. The IRS, like many large organizations, sought out expert advice on how to run its operation more effectively. The multimillion dollar advice was not surprising—scrutiny of the wealthiest taxpayers will yield the highest return. In order to focus its resources, the IRS engaged in a very public reorganization in 2000.

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When Bad Things Happen To Guarantors

By Charles D. Pulman, J.D., LL.M., CPA

A recent Michigan case is sending shudders through the real estate community with regard to a guarantor's personal liability for a deficiency on a non-recourse loan to a borrower that became insolvent due to market conditions. In the case of *Wells Fargo Bank NA v. Cherryland Mall Limited Partnership*, a limited partnership obtained a non-recourse real estate loan secured by a shopping center. The loan contained certain exceptions to the non-recourse provisions that are generally referred to as "bad boy carve-out exceptions." One exception was a provision that the borrower remain solvent throughout the life of the loan. If this provision was violated, the non-recourse loan became fully recourse. The guaranty extended to the carve-out exceptions, including the solvency provision.

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In This Issue:

Recent Trends in IRS Enforcement Activity and Specialized IRS Agents

By Michael A. Villa, Jr., J.D., LL.M.

In January of 2012, the IRS released its Fiscal Year 2011 Enforcement and Service Results.[1] The data indicates that in 2011 the IRS audited 1 in 8 individual returns reporting income of at least $1 million and 1 in 25 individual returns earning income of at least $200,000.

The number of audits for millionaire earners has increased 4% between 2010 and 2011. Increased enforcement trends for "high income" earners is consistent with the IRS's effort to reduce the "tax gap", which is defined as the amount of tax liability faced by taxpayers that is not paid on time. The most recent tax gap estimates were released by the IRS in January of 2012.[2] The estimates released covered tax year 2006, which was the most recent data available, according to the IRS. The data reveals approximately 15% of taxes owed went unpaid and the net tax gap was $385 billion, including enforcement efforts and late payments.

With a tax gap for 2006 that was large enough to cover the federal deficit at that time, it is understandable why taxpayers and tax professionals are witnessing increased IRS enforcement activity. One of the arenas of increased enforcement activity can

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Time Sensitive: Preserving More Favorable Franchise Tax Deductions Through Protective Refund Claims

By Jason B. Freeman, J.D., CPA

With the dust now settled on the Texas Supreme Court's decision in *In Re: Allcat Claims Service, L.P.*, and that Court having recently heard yet another case challenging the state's franchise tax on constitutional grounds, at least one thing is clear about the state's "new" tax regime: Its 2008 implementation injected a laundry list of uncertainties into the state's tax laws. Litigation and Comptroller guidance have naturally resolved some of these. But as taxpayers and practitioners know, issues abound, and many unanswered questions remain.

Not least among them: Whether a taxpayer can file an amended report to change the method originally used to compute its tax? For example, can a taxpayer who originally used the default 70-percent methodology on its franchise tax report later file an amended report claiming a cost-of-goods-sold deduction instead when that deduction would result in a refund?

Particularly in light of the tax regime's recent vintage and the numerous developments and clarifications in the law since its inception—many of which were unaccompanied by significant fanfare or publicity—the cautious tax advisor should, at the very least, undertake

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A Third Bite at a Shrinking Apple — The IRS's New Offshore Voluntary Disclosure Program

By Stephen A. Beck, J.D., LL.M.

Encouraged by its collections of more than $4.4 billion from prior programs, the IRS recently announced that it has opened a third offshore voluntary disclosure program (the "New Program") to enable taxpayers to disclose their ownership of foreign assets while potentially qualifying for reduced penalties for prior noncompliance.

The terms of the New Program are similar to the terms that applied under the 2011 Offshore Voluntary Disclosure Initiative (the "OVDI"), with three key exceptions. (For a detailed description of the terms of the OVDI, please see "Get It While It's Hot—The IRS's 2011 Offshore Voluntary Disclosure Initiative—Time is Running Out to Qualify for Reduced Penalties," Meadows Collier Newsletter–Volume 5, available at: http://meadowscollier.com/news/articles.)

The first significant difference is that the New Program does not have any fixed deadline by which disclosure must be made in order to participate. Instead, the New Program is open indefinitely, although the IRS cautions that it can decide to end the program

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Here We Go Again — Carried Interest Legislation Back on the Table for 2012

By Stephen A. Beck, J.D., LL.M.

In an odd twist, the Republican Presidential primary has sparked a renewed focus on carried interest legislation in Congress.

In response to repeated calls by Newt Gingrich to disclose his federal income tax returns, Mitt Romney recently revealed that his effective federal income tax rate is "probably closer to 15% than anything" because it is largely derived of investment gain or income subject to the long-term capital gain rate.

The day after Romney's 15% admission, House Ways and Means Committee ranking Member Sander Levin (D-Mich.) announced that he plans to reintroduce legislation in 2012 that, according to his website, would fix the "carried interest tax loophole." Levin stated: "Gov. Romney's statement that his tax rate is close to 15

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What is different about these new rounds of audits?

The IRS Large Business & International Division—LB&I (formerly known as The Large & Mid Size Business Division—LMSB) is rolling out specialized exam teams to conduct repetitive examinations of similar items. Even though the IRS recently issued guidance on Section 263A, expect a continuing push by the IRS on this topic.

The difference in these types of audits is that the IRS is showing up only after conducting a fairly extensive analysis of certain target issues. For example, in one recent exam, the IRS agent identified that Section 263A was an issue. We quickly learned that the examiner had just finished 4 other Section 263A exams within the last 12 months. Furthermore, at the opening audit meeting, the examiner already had computed a proposed Section 263A adjustment.

Another difference in the new round of examinations is that the IRS examiners now have the luxury of being able to use IRS counsel to assist in the examination of a case. The attorneys are very helpful in increasing the magnitude of certain IRS adjustments. The corollary is the IRS posits that attorneys are preventing many examiners from wasting time on issues that will generate no income for the government. The presence of the IRS attorney is almost always behind the scenes. The IRS attorney will not be at the opening exam conference that includes a plethora of IRS employees from appraisers to excise tax specialists to employment tax agents. The participation is usually obvious in particularly well thought out and worded information document requests (IDRs) and during the IRS interview process.

One of the more unsettling differences in the new round of examinations is the IRS inclusion of preparer penalties in the mix of items to be considered during an examination. The inclusion of preparer penalties certainly brings a new dimension to an examination. Even though the preparer penalties may not be very large from a monetary standpoint, the effect reaches beyond mere dollars and cents. Specifically, a preparer penalty can result in a direct referral to the IRS Office of Professional Responsibility (OPR) generating an entirely separate proceeding.

In the new era of IRS exams, one cannot forget the strides being made by the IRS Global High Wealth Industry Group a/k/a "The Wealth Squad". This division of LB&I is conducting "holistic" examinations that cover all aspects of taxpayers' personal and business activities from a horizontal and vertical perspective. The IRS wants to learn "what is really going on" with certain high net worth taxpayers. Currently, the LB&I program applies to taxpayers with assets of $10mm and up. The program has such promise that it is anticipated that it will be replicated for lower dollar exams such as the 1 in 8 millionaires who are being examined by the IRS.

Undisclosed offshore activities

Finally, the IRS continues its full assault on taxpayers with undisclosed offshore activities. Accordingly, all examinations now include standard offshore inquires in the initial interview. Furthermore, the IRS is beginning to pursue exam leads from both a civil and criminal perspective from the two most recent offshore disclosure programs.

The IRS recently announced a new third offshore voluntary disclosure program. The IRS is showing that it is a fast learner on offshore matters. Many tax practitioners are expecting the IRS to cast a keen eye towards the voluntary disclosures in the new third offshore voluntary disclosure program (Offshore Voluntary Disclosure 3.0) in light of the patterns they have encountered in the first two programs. While the IRS was scrambling to handle all of the voluntary disclosures in the first two programs, the IRS is expected to be much more discriminating in the new program which could spell trouble for taxpayers who are not aware of the nuances and traps for the unwary that lie in making a voluntary disclosure through the IRS Criminal Investigation Division.

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When Bad Things Happen, continued from page 1

As it turned out, the borrower was unable to make the debt service payments on the loan and the lender, Wells Fargo, foreclosed with a deficiency of approximately $2,000,000.00. Wells Fargo then sued the borrower and guarantor for the full amount of the deficiency, claiming that the solvency provision was violated as evidenced by the fact that the borrower could no longer make payments on the loan and the borrower had no other assets.

Although the guarantor strenuously argued that the intent of the solvency provision was to create personal liability only if the insolvency of the borrower was caused by a "bad act" of the guarantor or the partnership, the court held otherwise and concluded that the solvency provision in the loan agreement meant what it said. The court stated that the reason for insolvency was not relevant. While many bad boy carve-out exceptions do depend on an act or omission of the borrower (such as fraud or misconduct), the court held that if the solvency provision is breached, it did not matter how the insolvency of the borrower arose.

Guarantors of non-recourse real estate loans containing provisions relating to the solvency of the borrower (or the requirement to maintain adequate working capital of the borrower) need to give close attention to the financial condition of the borrower and the status of the loan since the guarantor could end up personally liable for all or a portion of the "non-recourse" loan if the borrower becomes insolvent (or does not have adequate working capital). If a non-recourse loan is being negotiated currently, solvency and working capital provisions need to be deleted or severely restricted to circumstances that are clearly understood and resemble "bad boy" acts.

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to analyze and rethink whether a taxpayer may indeed have been able to utilize a more advantageous calculation method than is reflected on its original report. Perhaps not surprisingly, many taxpayers may answer that question affirmatively. Those affirmative answers translate into potential refund claims.

The relatively large number of potential refunds is due in no small part to the unprecedented ambiguities and uncertainties in the law that were left in the wake of the Legislature's hasty implementation of the new margin tax regime in 2008. Faced with these uncertainties, many taxpayers and practitioners cautiously—and on occasion erroneously—concluded that they did not qualify for a particular deduction method. For example, many taxpayers erroneously concluded that they did not qualify for a cost-of-goods-sold deduction, reasoning that they were in the business of providing "services."

Some taxpayers in the oil and gas well servicing industry, for instance, drew precisely this conclusion. Yet, after the original due date for first-year returns, the Comptroller quietly issued FAQs that rendered this conclusion erroneous. The Comptroller clarified that "[o]ilfield services that constitute construction, improvement, remodeling, repair, or industrial maintenance of oil and gas wells can be included in COGS"—a connection that many tax practitioners failed to make. *See* Texas Comptroller Cost-of-Goods-Sold FAQ No. 22.

The scenario, of course, is by no means limited to companies in the oil and gas well servicing industry or erroneous failures to use a cost-of-goods-sold deduction. For example, a number of taxpayers in other industries erroneously concluded that they qualified for a cost-of-goods-sold deduction only to have the Comptroller later determine that they did not qualify to use that methodology. In such instances, the Comptroller disallowed the claimed

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be seen in the IRS's specialized agents who conduct exams that raise unique procedural and strategy issues for tax professionals.

Specialized IRS Agents

Specialized IRS Agents include Special Enforcement Program ("SEP") Agents.[3] As discussed below, there are certain factors that a tax professional should consider when handling this type of exam.

What is SEP?

Agents in SEP are "financial investigative specialists."[4] SEP Agents are also described as "experts in the identification and development of cases with **fraud potential**."[5] According to the IRS, SEP is a specialized compliance program within the Small Business/Self-Employed Operating Division ("SB/SE") that is directed toward a segment of the population which derives substantial income from either legal or illegal activities and intentionally understates their tax liability.[6]

In 2011, there were material changes to the IRM regarding the SEP program. For example, the IRM was revised to more accurately reflect the types of cases which SEP examines.[7] Importantly, "SEP evolved from a *Strike Force* program focused on organized crime and illegal activity into a compliance program with emphasis on identifying, developing and investigating fraudulent income and expense issues of both legal and illegal entities."[8] This is noteworthy in that SEP evolved from a group that focused on illegal activity into a compliance program that exams both legal and illegal activities.

Therefore, SEP often examines legitimate business entities or individuals, which may have fraudulent income and expense issues. Accordingly, if your client is subject to a SEP exam, the Agent will be on high alert to look for issues that may rise to the level of fraud or even criminal referral.

What Type of Cases will SEP Agents Examine?

SEP cases include, but are not limited to:

1. Unreported income	13. Pornography
2. False expenses/credits	14. Embezzlement and theft
3. Abusive return preparers	15. Political corruption
4. Frivolous filers/non-filers	16. Credit card fraud
5. Abusive trusts/abusive trust schemes	17. Bank fraud
6. Tax Shelters	18. Currency violations (CBRS/SAR)
7. Employment Tax and/or Excise Tax	19. Offshore activities
8. Healthcare fraud	20. Internet fraud
9. Racketeering/organized crime	21. Compliance Initiative Projects (CIP)
10. Narcotic trafficking	22. Whistleblower cases
11. Illegal gambling operations	23. Promoter Investigations
12. Prostitution	24. Voluntary Disclosure Program cases[9]

As the above list indicates, SEP cases are far-reaching and categorically broad. A practitioner is therefore well-advised to research whether the particular IRS Agent assigned to his or her case is with SEP. If it is a SEP Agent, you will be armed with the knowledge that the Agent is a financial investigative and fraud specialist and work your case accordingly.

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Special Factors for Practitioners to Consider When Handling a SEP Exam

The SEP exam purports to be a civil exam at the outset, and may very well remain a civil exam, but be aware that criminal referral and/or civil fraud penalties may loom in the background. The prudent tax professional must be aware that "many SEP cases result in recommendations for criminal prosecutions and an even greater number involve assertions of the civil fraud penalty."[10] In addition, SEP agents spend significant time working joint investigations with IRS Criminal Investigation ("CI").[11] SEP Agents may also employ investigative techniques that carry greater consequences than a standard audit.

For example, the SEP Agent may seek interviews of parties related to the exam and/or attempt to secure affidavits.[12] Remember that these are cases in which the potential for civil or criminal fraud allegations is high, so consider whether your client should agree to an affidavit or whether your client will be unwittingly attesting to a false affidavit, which carries criminal consequences.[13]

Practitioners facing a SEP civil exam should be aware of the potential increased likelihood that the case will be referred for criminal investigation, and that any information disclosed during the civil exam likely can be used against the taxpayer in a subsequent criminal case or to assist the government in proving fraud.

In a SEP civil exam, the agent is considered an expert in fraud cases and has a responsibility to develop issues that have a significant fraud potential.[14] The IRM specifies that the civil agent should suspend examination and prepare for referral to CI when "firm indications of fraud" are present.[15]

Courts have given considerable deference to the Agent's determination of when "firm indications of fraud" are present.[16] Even where an Agent clearly waited too long to make a referral, there is likely no recourse for the taxpayer. Many courts have held that IRM violations carry no legal effect unless the violations interfere with the taxpayer's constitutional rights as a result of the agent using deceit, trickery, or misrepresentations to obtain evidence.[17]

Accordingly, practitioners should consider the potential adverse consequences of making admissions to the SEP Agent if there is concern that the case will be referred for criminal investigation, or if fraud penalties are likely to be asserted, because those admissions will likely be admissible against the taxpayer.

If you have any questions or would like additional information regarding IRS Enforcement or Specialized IRS Agents, please contact Mike Villa at mvilla@meadowscollier.com.

[1]http://www.irs.gov/pub/newsroom/fy_2011_enforcement_results_table.pdf.

[2]http://www.irs.gov/newsroom/article/0,,id=252038,00.html; IR– 2012- 4; Jan. 6, 2012.

[3]Internal Revenue Manual ("IRM") 4.16.1.1(1).

[4]IRM 4.16.1.3.

[5]*Id.* (emphasis added).

[6]IRM 4.16.1.1(1).

[7]IRM 4.16.1.

[8]IRM 4.16.1.1(2).

[9]IRM 4.16.1.2(3).

[10]IRM 4.16.1.3.3(1).

[11]IRM 4.16.1.3.6(1).

[12]IRM 4.16.1.3.2.

[13]IRM 4.16.1.3.2.1(4) ("The average individual is not familiar with the law, therefore, the SEP agent should advise them that preparing or the giving of a false statement is a criminal offense. Therefore, an attested statement has greater validity when properly prepared and voluntarily given.")

[14]IRM 4.16.1.2(1)(A).

[15]IRM 25.1.2.2 and 25.1.3.1.

[16]See, e.g., *United States v. McKee*, 192 F.3d 535 (6th Cir. 1999); *United States v. Caldwell*, 820 F.2d 1395 (5th Cir. 1987); *Groder v. United States*, 816 F.2d 139 (4th Cir. 1987).

[17]See, e.g., *United States v. Powell*, 835 F.2d 1095 (5th Cir. 1988); *Caldwell*, 850 F.2d 1395; *Groder*, 816 F.2d 139; *but see United States v. Tweel*, 550 F.2d 297 (5th Cir. 1977) (stands as the rare case in which the taxpayer was able to prove deceit, trickery, or misrepresentation and suppress the evidence obtained in the civil audit).

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at any time. The amount of advance notice the IRS may provide, if any, prior to the termination of the New Program is unclear. Thus, any taxpayer considering the New Program should determine as soon as possible whether they wish to participate.

The second significant difference is that the New Program imposes a higher fixed penalty for prior nondisclosure as compared to the OVDI. Under the New Program, a taxpayer must pay a penalty of 27.5% of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years prior to the disclosure. This is up from the 25% penalty in the OVDI. The reduced 5% and 12.5% penalties that were provided under the OVDI, however, will continue to be available to qualifying participants under the New Program.

Third, the IRS cautions that the terms of the New Program can change at any time going forward. It is therefore reasonable to expect that the aforementioned penalty rate under the New Program may increase above 27.5% and that other terms may become less advantageous as time goes on.

Whether a particular taxpayer would benefit from the terms of the New Program will depend on careful analysis of certain factors, such as: (i) the penalty amounts that could apply under the New Program as compared to the penalties that could otherwise apply under the Internal Revenue Code; and (ii) the number of years that could be open under the applicable statute of limitations as compared to the eight year period for which disclosure must be made, and tax, interest and penalties must be paid, under the New Program.

Meadows, Collier, Reed, Cousins, Crouch & Ungerman, LLP has already assisted hundreds of clients with participating in the prior offshore voluntary disclosure programs and would be pleased to assist with advising your clients regarding the advantages and disadvantages of the New Program that could apply in their particular situation.

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percent likely reflects that he has benefitted from a loophole that we have been trying to close for years."

A "carried interest" is a profits interest in an entity taxed as a partnership for federal income tax purposes. Carried interests are often granted to investment fund managers as compensation for their investment management services performed for the partnership holding the investments.

Compensation for services is, of course, taxed at the marginal federal income tax rate applying to the service provider taxpayer (current maximum rate of 35%). The income derived from a profits interest, however, is generally

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taxed according to the character of the income at the underlying partnership level. Thus, if an investment management partnership sells an investment held for more than twelve months or if that partnership receives a qualified dividend, the allocable share of that gain or income may be taxable to the carried interest investment manager partner at the long-term capital gain rate (current maximum rate of 15%).

Efforts to require carried interest returns to be taxed as ordinary income are nothing new. Between 2007 and 2010, the House of Representatives passed carried interest legislation on four separate occasions, but each time the bill failed to pass in the Senate.

It is unclear whether the 2012 carried interest will have any chance of passage in the current legislative session. Many pundits believe that Congress will not take significant legislative action until after the 2012 Presidential election.

On the other hand, the taxation of carried interests is a current "hot button" issue. The fact that carried interest legislation is being introduced for the fifth time in six years and that reforms to the taxation of carried interests have been included in the three most recent Presidential budget proposals are indications that this issue is not going away.

More significantly, the taxation of carried interests may be a smaller issue of larger debate. Recent statements made by various members of Congress indicate that the push to end beneficial treatment of carried interests could extend into a broader effort to eliminate, or at least reduce, the long-term capital gain preference for a broader spectrum of taxpayers.

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deduction and recalculated the tax using the 70-percent-of-revenue methodology. Although many of these taxpayers would have qualified for—and been better off using—a compensation deduction, many simply paid the assessment and went on down the road without challenging the Comptroller's position that they had no right to use another deduction method. It may be time for those taxpayers to revisit that position.

Of course, analyzing whether a client qualifies for another, more beneficial method than was used to calculate its tax is only step one—but it is an analysis that the cautious tax advisor should engage in.

Assuming that a taxpayer has passed step one and determined that it indeed qualified to take a more advantageous deduction method than was originally claimed or permitted, does that taxpayer now have the right to amend its erroneous report or otherwise file a claim for refund and utilize that deduction? Despite the rule—a rule engrained in Texas law since time immemorial—that taxpayers have the right to timely amend their state tax reports to correct an error or seek a refund, the Texas Comptroller's regulations facially indicate that the answer is no, at least when the taxpayer is attempting to change to a cost-of-goods-sold or compensation deduction.

And that is indeed the Comptroller's official position—a position that, it should be noted, at least one district court has already refused to apply.

Indeed, there is a push underway to invalidate the Comptroller's regulations on this issue, a push that has already garnered some legal authority. And there is reason to be optimistic that, in time, the movement will ultimately prove successful. The regulations may yet be invalidated as taxpayer litigation winds its way through the administrative and judicial systems. A recent district court decision—the first to involve a strand of this issue—held

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that the taxpayer's election was not irrevocable; it could be changed. Other cases are in the pipeline that will bring further clarification on the issue. And certain legislators have also expressed support for statutory amendments that would ensure the right to use a different method on an amended report.

This all sounds promising. And it is. But here's the rub: Texas law only provides a four-year period to file an amended report claiming a refund. *See* Tex. Tax Code §§ 111.107, 111.201. For first-year reports, that means the deadline to amend is rapidly closing in. For some taxpayers, the window of opportunity may close during the first part of this year—before the issue will be resolved by the courts or the Legislature. And if it is ultimately resolved favorably, being in position to take advantage of an amendment could mean the difference between a refund and an unwitting contribution to the state's coffers.

So what can the cautious practitioner do to protect their client—and possibly themselves? If the facts are right, file a protective refund claim. Raise the issue and preserve the ability to claim a refund, contingent on a favorable resolution of the issue. The time to start thinking about doing so is now—if not yesterday. The upside could be rather significant; the downside, relatively minimal or nonexistent. With this calculus and the window of opportunity closing in, tax practitioners and their clients should be re-thinking their first-year franchise tax report methodology in light of any relevant changes or clarifications in the law. In the process, they should consider whether it makes sense to file a protective refund claim to preserve the position that a more favorable calculation method is available.

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THE FIRM CONGRATULATES SHARON (SHARI) L. ELLINGTON

for receiving the *Dallas CPA Society Outstanding Committee Member of the Year Award*, for her involvement in the 2011-2012 Leadership Development Academy Committee.

Shari received this award at the Dallas CPA Society Annual Meeting on Tuesday, January 31, 2012. Shari has also been accepted into the 2012-2013 *Leadership Academy* of The State Bar of Texas Tax Section. Shari is one of 21 participants in the inaugural class. The Leadership Academy allows young tax lawyers to develop their leadership skills as well as network with other tax lawyers throughout the state.

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Upcoming Speaking Engagements

(For complete speaking engagement information, please visit our firm website at www.meadowscollier.com. Click on the News & Events tab from the Home page of the website.)

MARCH 27, 2012 — SARAH WIRSKYE

"Health Care Fraud"
Health Care Group @ BKD, LLP
Dallas, TX

APRIL 30, 2012 — DAVID COLMENERO

"Top Audit Issues for High-Net Worth Individuals"
2012 AICPA Tax Strategies for the High-Income Individual Conference
Las Vegas, NV

MAY 1, 2012 — DAVID COLMENERO

"The Benefits of Benevolence"
2012 AICPA Tax Strategies for the High-Income Individual Conference
Las Vegas, NV

MAY 4, 2012 — DAVID COLMENERO, ANTHONY DADDINO

Colmenero – *"The Texas Comptroller's Office: Current Areas of Interest for Audit and Investigation"*
Daddino – *"Worker Classification"*
Dallas CPA Society's 2012 Convergence
Dallas, TX

MAY 8, 2012 — TREY COUSINS

Topic "TBA"
Midland Odessa Business & Estate Council
Midland, TX

MAY 10, 2012 — ALAN DAVIS

"Life Insurance Issues and Estate Planning"
Midland Memorial Foundation and Midland College Foundation Annual Estate Planning Seminar
Midland, TX

MAY 17, 2012 — JOEL CROUCH, JOSH UNGERMAN

Crouch – *"Compliance Issues for U.S. Partnerships with Foreign Partners and U.S. Partners in Foreign Partnerships"*
Ungerman – *"IRS New Techniques and Trends"*
North American Petroleum Accounting Conference (NAPAC)
Dallas, TX

JUNE 7, 2012 — CHUCK MEADOWS

"Making Ends Meet: Getting Paid Consistently and Ethically"
NACDL's 2012 West Coast White Collar Crime Conference
Lake Tahoe, NV

JUNE 21, 2012 — TREY COUSINS

"The IRS. The Tax Attorney. The Valuator/Appraiser. Perspectives and Guidance on Navigating through Valuation Engagements"
National Association of Certified Valuators and Analysts Conference
Dallas, TX

AUGUST 9, 2012 — TREY COUSINS

"View from the Office of Professional Responsibility (OPR)"
Fort Worth Chapter/TSCPA Tax Institute
Fort Worth, TX

AUGUST 10, 2012 — JOEL CROUCH

"Worker Classification"
Fort Worth Chapter/TSCPA Tax Institute
Fort Worth, TX

AUGUST 13, 2012 — DAVID COLMENERO, SARAH Q. WIRSKYE

Colmenero – *"Selecting a Forum for Challenging an Assessment or Refund Denials"*
Wirskye – *"Civil and Criminal Fraud Audits and Investigations"*
TSCPA Texas State Taxation Conference
Houston, TX

AUGUST 23, 2012 — JOEL CROUCH, TOM HINEMAN, CHARLES PULMAN

Topics "TBA"
Panhandle Chapter/ TSCPA Tax Institute
Amarillo, TX

SEPTEMBER 19, 2012 — SARAH Q. WIRSKYE

"Health Care Fraud and Compliance"
Dallas Bar Association Health Law Section
Dallas, TX

DECEMBER 13-14, 2012 — TREY COUSINS

Topic "TBA"
Louisiana Society of CPAs Tax Conference
New Orleans, LA

2013 Budget Proposals Raise Stakes for 2012 Planning

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

For 2012, there is a $5,000,000 exemption for federal gift, estate and generation-skipping transfer ("GST") taxes and the maximum tax rate for all three transfer taxes is 35%. As current law stands, the federal gift, estate and GST tax rules as they existed in 2001 are scheduled to return on January 1, 2013. This would include a $1,000,000 estate, gift and a GST tax exemption amount and a maximum tax rate of 55%.

Many, if not most, practitioners believe that these exemptions are too low and that Congress will ultimately settle at some higher amount (e.g., $3.5 million). Whether the gift tax exemption will remain unified at that amount or return to $1,000,000 is also unknown. Additionally, most believe that the new portability rules will eventually be extended as well.

On February 13, 2012, the Obama administration released its fiscal 2013 budget and the Treasury's General Explanations of the budget (referred to as the "Greenbook"). These new budget proposals include the following estate, gift and GST tax provisions: (i) $3,500,000 estate and GST tax exemptions, (ii) a $1,000,000 gift tax exemption, and (iii) a 45% tax rate. The proposal would also extend the portability rules.

It is unlikely that we will know anything more than the above prior to the November 2012 elections and possibly not until sometime in 2013. In any event, these proposals add additional incentive for our clients to act during 2012 while the planning environment is so favorable.

Many commentators believe that at least some of the $5,000,000 gift tax exemption will go away. The proposed return to a $1,000,000 gift tax exemption increases the pressure on clients to act during 2012. It is hoped that the current unified gift and estate tax exemption structure will survive, but the proposal clearly indicates this administration's desire to bifurcate those exemptions and provide a much smaller exemption for lifetime transfers.

In addition to other perceived advantages to 2012 planning, the following two items included in the proposed budget are apt to weigh heavily on our clients.

First, the budget proposal introduces the concept that the assets of a grantor trust will be included in the grantor's estate for estate tax purposes. This would take away the transfer tax efficient technique of transferring assets to a grantor trust and allowing the grantor to continue to pay the income tax on future income. Additionally, assets can currently be sold to the trust by the grantor with no gain recognition. If adopted, the proposal would end this very attractive planning technique. In this regard, however, the proposal also contains the very important concept that existing trusts would be grandfathered into the system. Accordingly, clients should now carefully consider the use of this technique during 2012 while it remains available.

Secondly, the budget proposal introduces the concept that trusts exempt for GST tax purposes may exist for only a limited term. The proposal includes a provision whereby a trust's inclusion ratio for GST purposes would automatically reset to 1.0 90 years from the date of creation, effectively ending such a trust's GST exemption. Currently, there is no time limit for such trusts other than the applicable state law which limits the length of trusts to the "rule against perpetuities," a time period which ends 21 years after the death of everyone alive at the trust's creation. In this regard, many states have extended or even abolished this rule so that trusts have no termination period and therefore, for GST purposes, last forever. It is important that our clients know of this proposal to limit the GST period and also point out that again, like the grantor trust proposal above, the budget provision would grandfather existing trusts from this rule.

Thus, the current favorable planning environment, the threat of a less lenient tax environment on the horizon and the ability to lock in valuable planning techniques for years to come will likely prompt our clients to become very active in the planning arena this year.

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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. March 2012 edition.

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