The Texas Tax Lawyer

October 2008
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www.texastaxsection.org

2008

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CHAIR'S MESSAGE

As you know, in recent years we have increased dramatically the activity and national profile of our Section. And we are off to a another great start for the 2008-2009 year.

The Officers and Council of the Section met this summer to review and reaffirm our goals for the Section and to set an ambitious agenda for the year. Our goals are: (1) to provide world-class education through accessible and relevant CLE; (2) to work to improve the substance and administration of state and federal tax laws; (3) to use our knowledge, experience and resources to provide pro bono legal services to those who cannot afford the services of tax lawyers; (4) to enhance the profile of our section and our members; and (5) to have fun while working toward these goals.

To achieve these goals and carry out our agenda, we need your help and participation. If you are not already involved in our Section's activities, or, if you would like to become more involved, please call (214.969.2797) or email me (dmicciche@akingump.com). There is a place for you, and we will get you going. Also, please check our website regularly to keep up with our latest activities: http://www.texastaxsection.org. We will be upgrading the website technology soon, but the content on the website is current and easily accessible.

CLE

Under the leadership of our CLE chair, Tina Green, the Tax Section now provides both live and web-based continuing legal education, and we are building a library of webcasts on basic tax practice skills that can be accessed at any time. I would like to mention just a few of the CLE projects that are currently in the works.

We are now presenting two new CLE webcasts every month. Check our website for upcoming programs and to review our library of over 30 programs, including recordings from the Texas Federal Tax Institute held in June, which can be accessed at any time. To encourage those of you who have never watched one of our webcasts, we are going to provide a free CLE webcast this fall for all of our Section members with a speaker of national prominence. I will send an email about the free CLE webcast with all of the details soon.

On Friday, November 7, 2008, we will hold the 11th Annual International Tax SYmposium at The Center for American & International Law at Legacy Park in Plano, Texas. Details are on our website.

In November and December, in Dallas, Austin, and Houston, we are co-sponsoring the 2008 Texas Margin Tax Seminar with The University of Texas. The Dallas program will take place on November 19 and 20 at the Cityplace Conference Center. The Austin program will held on December 4 and 5 at the Norris Conference Center. The Houston program will be held on December 11 and 12 at the Hyatt Regency. For more information, check our website or go directly to The University of Texas link at:
http://www.utcle.org/conference overview.php?conferenceid=846

We are also currently working with the State Bar of Texas Business Law Section and the Texas Society of CPAs on joint CLE programs that will be presented next spring. Also, in the spring, we will hold our Annual Property Tax Conference. The Advance Tax Law Course will be held next summer

And, of course, this publication, ***The Texas Tax Lawyer***, under Alyson Outenreath's guidance, provides some of the best and most relevant tax articles, model forms, and updates on the tax law.

Government Submissions

The Section is also active in providing comments to governmental authorities on the tax law. Each of our substantive committees is working on at least one comment proj ect on federal or state tax law. Dan Baucum and Stephanie Schroepfer lead our Committee on Government Submissions ("COGS") and coordinate our comment projects with the leaders of our substantive committees. We need your help. Last year, we provided eight comment projects to federal and state tax authorities, and we are already on pace to exceed that total.

Pro Bono

In addition, the Section has an active pro bono program. Under the leadership of our Pro Bono Chair, Elizabeth Copeland, we initiated an assistance program for pro se taxpayers docketed before the United State Tax Court. Beginning in January, we will be working with the Volunteer Income Tax Assistance Program to help low income families claim the earned income tax credit.
We also have a strong relationship with Texas C-BAR, a pro bono organization that helps match transactional lawyers with pro bono projects for organizations that serve the needy. This is important work. Please get involved.

Enhancing the Profile of Our Section and Our Members

Our excellent CLE programs, our comment projects, and our pro bono activities all enhance the profile, prestige, visibility, and stature of the Section and our members. Our new alliances with other sections of the bar, with the CPAs, and with the law schools also contribute to achieving this goal. This year we are initiating a Law School Writing Competition, and we will again be visiting each of the Texas law schools to discuss the practice of tax law with students.

In recent years, we have honored five of our colleagues with the Outstanding Texas Tax Lawyer Award. This year's nomination form is on our website and on page _ of this publication. Please consider nominating a worthy individual for this award.

Finally, I would like to thank my predecessor, Kevin Thomason, for his outstanding work in leading our Section last year and for his many years of service to the Section. In addition to motivating the entire Section to work together to achieve our most productive year ever, Kevin has been leading the fight to ban tax strategy patents, and he again played a major role in organizing our most visible and nationally recognized CLE program, the Texas Federal Tax Institute.

Please let me or one of my fellow officers, Tyree Collier - Chair-Elect, Patrick O'Danie lSecretary, and Mary McNulty - Treasurer, know if you have any thoughts, ideas, or suggestions about our Section.

Thank you. I look forward to working with all of you and to a great year. Get involved. It's fun.

Daniel J. Micciche

CALL FOR NOMINATIONS FOR OUTSTANDING TEXAS TAX LAWYER AWARD

The Council of the Section of Taxation is soliciting nominees for the Outstanding Texas Tax Lawyer Award. Please describe the nominee's qualifications using the form below. Nominees must: be a member in good standing of the State Bar of Texas or an inactive member thereof; have been licensed to practice law in Texas or another jurisdiction for at least ten years; and have devoted at least 75 percent of his or her law practice to taxation law.[1] In selecting a winner, the Council will consider a nominee's reputation for expertise and professionalism within the community of tax professionals specifically and the broader legal community; authorship of scholarly works relating to taxation law; significant participation in the State Bar of Texas, American Bar Association, local bar associations, or legal fraternities or organizations; significant contributions to the general welfare of the community; significant pro bono activities; reputation for ethics; mentorship of other tax professionals; experience on the bench relating to taxation law; experience in academia relating to taxation law; and other significant contributions or experience relating to taxation law.

Nominations should be submitted to Dan Micciche, either by email (dmicciche@akingump.com) or hardcopy (fax number 214-969-4343) no later than January 31, 2009. The award will be made at the 2009 Texas Federal Tax Institute in San Antonio the following June.

NOMINATION FOR OUTSTANDING TEXAS TAX LAWYER AWARD

Nominee Name: ____

Mailing Address: ____

____

Description of Nominee's Contributions/Experience Relating to Taxation Law:

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1 "Law practice" means work performed primarily for the purpose of rendering legal advice or providing legal representation, and also includes: service as a judge of any court of record; corporate or government service if the work performed was legal in nature and primarily for the purpose of providing legal advice to, or legal representation of, the corporation or government agency or individuals connected therewith; and the activity of teaching at an accredited law school; and "Taxation law" means "Tax Law" as defined by the Texas Board of Legal Specialization's standards for attorney certification in Tax Law; tax controversy; employee benefits and executive compensation practice; criminal defense or prosecution relating to taxation; taxation practice in the public and private sectors, including the nonprofit section; and teaching taxation law or related subjects at an accredited law school. The award may be granted posthumously.

Dear Tax Colleague:

I am pleased to announce that the **11th Annual International Tax Symposium**, sponsored by the State Bar of Texas, Section of Taxation, International Tax Committee, will be held **on Friday, November 7, 2008** at The Center for American & International Law at Legacy Park in Plano. Texas.

Featured speakers and their topics are:

David L. Forst, Fenwick & West LLP
International Tax Update

Stewart R. Lipeles, Baker & McKenzie LLP
Melinda R. Phelan, Baker & McKenzie LLP
Hot International Topics

Val J. Albright, Gardere
Victoria Sherlock, KPMG
Examinations, Appeals and Litigation

A. Tracy Gomes, Gardere
Mark R. Martin, Gardere
Competent Authority and Advanced Pricing Agreements

Chris Hanna, Southern Methodist University
Dan Leightman, Gardere
International FAS 109

As you can see, we have a wonderful line-up of speakers this year for an extremely reasonable cost, $200. If you have participated in this Symposium in the past, you know that it is very well attended by tax professionals from around the state. For the Symposium, we have applied for five hours of participatory CLE credit including **one hour of ethics training** . We will also be applying for CPE credit.

Please mail the attached registration form immediately since space is limited to 70 participants. A detailed agenda and directions to the site are also attached. If you have any questions, please feel free to contact me at the number or email address shown below.

I look forward to seeing you this year.

Katrina H. Welch
Texas Instruments Incorporated
7839 Churchill Way, MS 3998
Dallas, TX 75251
(972) 917-6923
katrina@ti.com

11th ANNUAL INTERNATIONAL TAX SYMPOSIUM
NOVEMBER 7, 2008

■ The Center for American & International Law ■ 5201 Democracy Drive ■ Plano, TX

AGENDA

8:15 – 8:45 a.m.	**Registration and Continental Breakfast**
8:45 – 9:00 a.m.	**Welcome/Opening Remarks - Vice Chairs, State Bar of Texas Tax Section, International Tax Committee** • Mark Horowitz, Gardere, Houston, TX • Andrius Kontrimas, Fulbright, Houston, TX
9:00 – 10:00 a.m.	**International Tax Update** • David L. Forst, Fenwick & West LLP, Palo Alto, CA
10:00 – 11:00 a.m.	**Hot International Topic** • Stewart R. Lipeles, Baker & McKenzie LLP, Palo Alto, CA • Melinda R. Phelan, Baker & McKenzie LLP, Houston, TX
11:00 - 11:15 a.m.	**Break**
11:15 – 12:15 pm	**Examinations, Appeals and Litigation** • Val J. Albright, Gardere, Dallas, TX • Victoria Sherlock, KPMG, Houston, TX
12:15 – 1:00 p.m.	**Lunch**
1:00 – 2:00 p.m.	**Competent Authority and Advance Pricing Agreements** • A. Tracy Gomes, Gardere, Dallas, TX • Mark R. Martin, Gardere, Houston, TX
2:00 – 3:00p.m.	**FAS 109 and International Operations** • Chris Hanna, Southern Methodist University, Dallas, TX • Dan Leightman, Gardere, Houston, TX
3:00 – 3:15 p.m.	**Concluding Remarks**
3:15 p.m.	**Adjourn**

11th ANNUAL INTERNATIONAL TAX SYMPOSIUM
NOVEMBER 7, 2008

■ The Center for American & International Law ■ 5201 Democracy Drive ■ Plano, TX

REGISTRATION FORM

Name	
Firm/Company	
Address	
Telephone	
E-mail Address	

Please complete this form and mail it along with your
$200 check made payable to "Tax Section State Bar of Texas" to

Kathy Poteet
Texas Instruments Incorporated
7839 Churchill Way
MS 3998
Dallas, TX 75251

Be sure to reference the name of the attendee

Questions? Please contact:
Katrina Welch @ 972-917-6923
Mark Martin @ 713-276-5391

11th ANNUAL INTERNATIONAL TAX SYMPOSIUM
NOVEMBER 7, 2008

■ The Center for American & International Law ■ 5201 Democracy Drive ■ Plano, TX

DIRECTIONS
(972) 244-3400

From Downtown Dallas
Go north on the Dallas North Tollway. Take the Spring Creek Parkway/Tennyson Parkway exit and drive north on the Dallas North Tollway frontage road. Go through the first stop light and turn right at the next stop light (Tennyson Parkway). Proceed east on Tennyson for 0.7 mile, and we are on the right, at the corner of Tennyson Parkway and Democracy Drive.

From DFW Airport
Take the North Airport exit. Take 121 North and go approximately 18.5 miles to Legacy Drive. Turn right on Legacy Drive and go 1.5 miles to Parkwood Blvd. Turn right on Parkwood Blvd. and go 0.4 mile to Tennyson Parkway. Turn left on Tennyson Parkway and go 0.5 mile to Democracy Drive. We are on the right, on the corner of Democracy Drive and Tennyson Parkway.

From Love Field
Exit south from Love Field and turn left (east) on Mockingbird. Turn left onto Dallas North Tollway. Take the Spring Creek Parkway/Tennyson Parkway exit and drive north on the Dallas North Tollway frontage road. Go through the first stop light and turn right at the next stop light (Tennyson Parkway). Proceed east on Tennyson for 0.7 mile, and we are on the right, at the corner of Tennyson Parkway and Democracy Drive.

To the Membership of the State Bar of Texas Section of Taxation:

On behalf of the State Bar of Texas Section of Taxation, we are pleased to announce that **Lt. Governor David Dewhurst** has accepted the invitation of the State Bar of Texas Section of Taxation and several other associations to be the keynote speaker at a **special post-election luncheon on Thursday, November 13, 2008, at noon at the Hilton Anatole Hotel in Dallas**. The Lt. Governor's topic is **"Legislative Outlook for the 2009 Texas Legislative Session."** His presentation will focus on **"Taxes, Healthcare and Energy."** Other co-sponsors of this event include:

Texas Association of Business - Dallas Chapter
(In Partnership with the North Texas TAB Member Chambers of Commerce)
Dallas Bar Association Section of Taxation
Dallas CPA Society
Dallas-Fort Worth Business Group on Health
Dallas Human Resource Management Association, Inc.
State Bar of Texas Section of Taxation
Texas Alliance of Energy Producers
Texas Business Law Foundation
Texas Oil & Gas Association
Texas Society of CPAs

This event is important to North Texas and to our State Bar of Texas Section of Taxation community. Please make every effort to attend.

Cost for the luncheon is $55. Tables of eight are available at a cost of $440. **Please reserve your seat as soon as possible at www.cpadallas.org**. Space is limited.

Daniel J. Micciche
President
State Bar of Texas Section of Taxation

Texas Association of Business - Dallas Chapter (In Partnership with the North Texas TAB Member Chambers of Commerce) ★ **Dallas CPA Society** ★ **Dallas Bar Association Section of Taxation** ★ **Dallas Human Resource Management Association, Inc.** ★ **State Bar of Texas Section of Taxation** ★ **Texas Alliance of Energy Producers** ★ **Dallas-Fort Worth Business Group on Health** ★ **Texas Business Law Foundation** ★ **Texas Oil & Gas Association** ★ **Texas Society of CPAs**

Invite you to attend a Special Luncheon on Thursday, November 13, 2008, featuring

THE HONORABLE DAVID DEWHURST
LIEUTENANT GOVERNOR OF TEXAS

PRESENTING
"TEXAS LEGISLATIVE PREVIEW: TAXES, ENERGY & HEALTHCARE"

Please join us as Lt. Governor David Dewhurst brings sponsor members, business leaders and elected officials up-to-date on critical state issues affecting the Texas economy.

Thursday, November 13, 2008
Hilton Anatole Hotel
Coronado Ballroom
2201 Stemmons Freeway
Dallas, TX 75207
11:30 a.m. to 1:00 p.m.
$55.00 Individual
$440.00 Table for eight people

Seating is Limited -- Register online with Dallas CPA Society at
www.cpadallas.org

Payment by credit card available online; no invoicing available.
Reservations not canceled 48 hours prior to the meeting will be charged.

2008 TEXAS MARGIN TAX

November 19-20, 2008 • Cityplace Conference Center • Dallas, Texas

December 4-5, 2008 • Norris Conference Center • Austin, Texas

December 11-12, 2008 • Hyatt Regency • Houston, Texas

Earn up to 10.00 Hours of MCLE Credit and 12.00 Hours of CPE Credit for Accountants

MORNING

Presiding Officer:
Hon. Peter Brooks, Austin, TX

8:00 a.m. **Registration Opens**

Includes continental breakfast.

9:00 a.m. **.50 hr**

Calculating the Taxable Margin: How It Works, What's at Stake

Discussion of the elements of the margin tax computation, including combined reporting, and how the elements interrelate to determine the tax liability.

Ray H. Langenberg, Austin, TX

9:30 a.m. **1.00 hr**

Revenue Issues Under the Revised Texas Franchise Tax

This presentation will provide a discussion of key issues and opportunities relating to the computation of total revenue under the revised Texas franchise tax.

David E. Colmenero, Dallas, TX

10:30 a.m. **Break**

10:45 a.m. **.50 hr**

Top Ten Key Filing and Reporting Issues

Common filing mistakes and oversights in determining the affiliated/combined group, revenue, cost of goods sold deduction, and interaction among related entities.

Sue Baadsgaard, Dallas, TX

11:15 a.m. **1.00 hr**

Cost of Goods Sold

Lessons learned on how to tackle the computation of the cost of goods sold.

Steven W. Anderson, Houston, TX

AFTERNOON

Presiding Officer:
Christina A. Mondrik, Austin, TX

LUNCHEON PRESENTATION

12:15 p.m. **Pick up Box Lunch**

Included in conference registration fee.

12:30 p.m. **.75 hr**

The Margin Tax: The Big Business and Small Business Point of View

Dale Craymer, Austin, TX
Will Newton, Austin, TX

1:15 p.m. **Break**

1:30 p.m. **.50 hr**

Calculating the Compensation Deduction

This session will focus on the calculation and compliance issues of the compensation deduction, the identification of planning opportunities to increase the deduction, and the avoidance of potential traps for the unwary. In addition, this session will also address inter-entity services, staff leasing companies, management companies, and other industry-specific issues.

Eric Louis Stein, Austin, TX

2:00 p.m. **1.00 hr**

Unitary Taxation—The Texas Approach

With the adoption of the revised franchise tax, Texas has left behind more than 100 years of separate entity reporting and joined the ranks of states that require combined reporting if controlling interest requirements are met and the affiliated group operates in a unitary manner. Who is in, who is out, and is there anything that affiliated groups can do about it? This segment focuses upon factors and issues relevant to determining whether an affiliated group is or is not a unitary enterprise, with particular emphasis on the Texas approach.

Ira A. Lipstet, Austin, TX

3:00 p.m. **Break**

3:15 p.m. **.50 hr**

Control, Affiliation and Attribution

This presentation discusses the legal requirements built into the Texas Tax Code's new definitions of control and affiliation as well as the Texas Comptroller's regulatory attribution rule. The analysis is the foundation for determining which entities within an organization must be included on a combined group report. Special attention will be given to trusts.

Steven D. Moore, Austin, TX

3:45 p.m. **1.25 hrs**

Putting it Together: Practical Examples of the Application of Margin Tax

This visual presentation is aimed at the practical application of the new margin tax to common entities and structures. It includes comparative analysis of federal income tax treatment of the structures. Special attention will also be given to choice of entity; selected nexus issues; special partnership agreement provisions; and the treatment of passive entities within complex organizational structures.

William H. Hornberger, Dallas, TX
Steven D. Moore, Austin, TX

5:00 p.m. **Adjourn**

MORNING

Presiding Officer:
David H. Gilliland, Austin, TX

8:30 a.m. **Conference Room Opens**

Includes continental breakfast.

9:00 a.m. **.50 hr**

Apportionment

This presentation will cover apportionment under the revised franchise (margin) tax. The discussion will cover advanced apportionment issues with respect to combined groups, service providers and other taxpayers.

Christina A. Mondrik, Austin, TX

9:30 a.m. **.50 hr**

Taxable and Nontaxable Entities

Discussion of issues concerning whether trusts and other entities are subject to margin tax.

Elsbeth T. Peshel, Austin, TX

10:00 a.m. **.50 hr**

Possible Franchise Tax Changes

Discussion of possible amendments to the franchise tax, how current revenue expectations may affect the likelihood of change, and tax policy criticisms of the revised franchise tax.

David H. Gilliland, Austin, TX

10:30 a.m. **Break**

10:45 a.m. **1.50 hrs**

Margin Tax Q&A with the Comptroller's Office

Representatives from the Comptroller's Tax Policy Division will be on hand to answer common margin tax questions and field questions from the audience regarding the Comptroller's interpretation of the revised Texas margin tax.

Moderator: David H. Gilliland, Austin, TX
Teresa Bostick, Austin, TX
Janet Spies, Austin, TX

12:15 p.m. **Adjourn**

ABOUT THE COVER

"untitled," acrylic 16" x 20", is by Philip Trussell. For more information, call 512-499-8357.

REGISTRATION FOR TM08

Mail this registration form to:
The University of Texas School of Law, Attn. TM08
P.O. Box 7759, Austin, TX 78713-7759 ***or fax a copy to: (512) 475-6876***
Online registration available at www.utcle.org

PLEASE PRINT CLEARLY

Bar Card# ______ ❑ TX ❑ Other State: ______ ❑ N/A

Name [Mr. / Ms.] ______

Firm ______

Address ______

City ______ State ______ Zip ______

Telephone ______ Fax ______

Registrant's Email **(required)** ______

Assistant's Email **(optional)** ______

REGISTRATION:
Includes Course Binder and Box Lunch Presentation

DALLAS—NOVEMBER 19-20, 2008

- ❑ Early Registration Fee due by Wednesday, Nov. 12, 2008 .... $425.00
- ❑ Registration Fee after Wednesday, Nov. 12, 2008 .... $475.00
- ❑ State Employee Registration Fee ($300 after Nov. 12, 2008) $250.00

HOUSTON—DECEMBER 4-5, 2008

- ❑ Early Registration Fee due by Monday, Nov. 24, 2008 .... $425.00
- ❑ Registration Fee after Monday, Nov. 24, 2008 .... $475.00
- ❑ State Employee Registration Fee ($300 after Nov. 24, 2008) $250.00

AUSTIN—DECEMBER 11-12, 2008

- ❑ Early Registration Fee due by Wednesday, Dec. 3, 2008 .... $425.00
- ❑ Registration Fee after Wednesday, Dec. 3, 2008 .... $475.00
- ❑ State Employee Registration Fee ($300 after Dec. 3, 2008) $250.00

CONFERENCE PUBLICATIONS AND MEDIA
Allow 2–4 weeks from the Austin conference date for delivery.

- ❑ Course Binder *Without* Conference Registration $225.00
  Note: Conference registration includes Course Binder
- ❑ Audio CD Set $175.00
- ❑ eBinder on CD (PDF format) .... $225.00/$50.00
  ($225 purchased alone, $50 with registration or purchase of Course Binder or Audio CD Set)

IN-HOUSE CLE: Bring the conference in-house and learn at your convenience.
Allow 2–4 weeks from the Austin conference date for delivery.

- ❑ In-House CLE for 2—*Includes Audio CD Set and Course Binder* $750.00
- ____ Add participants (includes Course Binder) for $225 each .... $ ______

TOTAL ENCLOSED .... $ ______

METHOD OF PAYMENT

❑ Check (make checks payable to: **The University of Texas at Austin**)

❑ Purchase Order ❑ VISA or ❑ Mastercard (sorry, no AMEX or Discover)

P.O. or Card # ____ - ____ - ____ - ____

X ______ __ __ / __ __

Authorized Signature Exp. Date (mm/yy)

DALLAS

NOVEMBER 19-20, 2008

CONFERENCE LOCATION

Cityplace Conference Center
2711 North Haskell Avenue
Dallas, TX 75204
214-515-5100

Parking: Complimentary Self-Parking (subject to change)

KEY DATES

Registration & Cancellation

Nov. 12, 2008–5 p.m.
last day for early registration
add $50 for registrations received after this time

Nov. 14, 2008–5 p.m.
last day for full refund

Nov. 17, 2008–5 p.m.
last day for partial refunds
$50 processing fee applied

Weds., Nov. 19, 2008–9 a.m.
conference begins

AUSTIN

DECEMBER 4-5, 2008

CONFERENCE LOCATION

Norris Conference Center
2525 West Anderson Lane, Suite 365
Austin, TX 78757

Parking: Complimentary Self-Parking (subject to change)

KEY DATES

Registration & Cancellation

Nov. 26, 2008–5 p.m.
last day for early registration
add $50 for registrations received after this time

Nov. 28, 2008–5 p.m.
last day for full refund

Dec. 1, 2008 –5 p.m.
last day for partial refunds
$50 processing fee applied

Thurs., Dec. 4, 2008–9 a.m.
conference begins

HOUSTIN

DECEMBER 11-12, 2008

CONFERENCE LOCATION

Hyatt Regency
1200 Louisiana Street
Houston, TX 77002
713-654-1234

Parking: $12 Valet; Self-parking available nearby (subject to change)

KEY DATES

Registration & Cancellation

Dec. 3, 2008–5 p.m.
last day for early registration
add $50 for registrations received after this time

Dec. 5, 2008–5 p.m.
last day for full refund

Dec. 8, 2008 –5 p.m.
last day for partial refunds
$50 processing fee applied

Thurs., Dec. 11, 2008–9 a.m.
conference begins

PLANNING COMMITTEE

HON. PETER BROOKS —CHAIR
Austin, TX

CHRISTINA A. MONDRIK—CHAIR
Austin, TX

DAVID H. GILLILAND
Austin, TX

RAY H. LANGENBERG
Austin, TX

IRA A. LIPSTET
Austin, TX

TIMOTHY K. MASHBURN
Austin, TX

DANIEL J. MICCICHE
Dallas, TX

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STEVEN W. ANDERSON
KPMG LLP
Houston, TX

SUE BAADSGAARD
PricewaterhouseCoopers LLP
Dallas, TX

TERESA BOSTICK
Texas Comptroller of Public Accounts
Austin, TX

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Meadows, Collier, Reed, Cousins & Blau, L.L.P.
Dallas, TX

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Texas Taxpayers and Research Association
Austin, TX

DAVID H. GILLILAND
Clark Thomas & Winters, PC
Austin, TX

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Dallas, TX

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IRA A. LIPSTET
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Mondrik & Associates
Austin, TX

STEVEN D. MOORE
Jackson Walker L.L.P.
Austin, TX

WILL NEWTON
National Federation of Independent Business, Texas
Austin, TX

ELSBETH T. PESHEL
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Austin, TX

JANET SPIES
Texas Comptroller of Public Accounts
Austin, TX

ERIC LOUIS STEIN
Ryan, Inc.
Austin, TX

UTCLE

THE UNIVERSITY OF TEXAS AT AUSTIN
THE UNIVERSITY OF TEXAS SCHOOL OF LAW
P.O. Box 7759 • Austin, TX 78713-7759

This program is not printed or mailed at state expense.

MCLE This course has been approved for Minimum Continuing Legal Education credit by the State Bar of Texas Committee on MCLE in the amount of 10.00 hours. The University of Texas School of Law is a State Bar of California approved MCLE provider (#1944).

E-mail us at
utcle@law.utexas.edu
or call us at
512-475-6700
for more information

2008 TEXAS MARGIN TAX
November 19-20, 2008 • Cityplace Conference Center • Dallas, Texas
December 4-5, 2008 • Norris Conference Center • Austin, Texas
December 11-12, 2008 • Hyatt Regency • Houston, Texas

NON-PROFIT-ORG
U.S. Postage Paid
The University of Texas
School of Law

State Bar of Texas
Tax Section

Annual Law Student Tax Paper Competition

Eligibility: J.D. and LL.M. law students attending Texas law schools

Awards: First Place - $1,000 and plaque

Additional Awards for Second Place and Third Place at Judges' Discretion

Subject: Any federal or state tax topic

Entry Deadline: June 15th

Competition Rules:

Eligible Students: All J.D. and LL.M. degree candidates attending accredited Texas law schools either on a part-time or a full-time basis at the time the paper was written

Awards: First Place - $1,000 cash prize and plaque

Additional cash prize of $750 for Second Place and $500 for Third Place may be made in the sole discretion of the Judges if the number of entries and the quality of the papers merit additional awards

Paper Topic: Any federal or state tax topic (including topics relating to tax practice ethical and professional standards)

Eligible Papers:

a. Paper must be sponsored by a law school faculty member (limit of 6 papers per sponsor per competition)

b. Only one paper per student

c. Paper may be submitted for publication in law reviews or law journals; provided the version submitted to the competition does not reflect any changes made to the paper after submission of the manuscript for publication. Paper may not be the work product of employment or an internship (e.g. briefs, legal memoranda, opinion letters, etc.).

d. Paper must be written after May 15th of the year prior to the year of submission

e. Paper may not be longer than fifty pages (on 8 ½ by 11 inch paper, double spaced, twelve point font, and one inch margins on all sides) including footnotes, endnotes and exhibits. Footnotes and endnotes may be single spaced. Footnotes (rather than endnotes) are preferred, but not required.

f. Title of paper (or abbreviated title) and page number must appear on each page of the paper

Submission:

a. All entries must be received after January 15th and before June 16th

b. All entries must be submitted electronically as attachments to an e-mail message sent to donna@clesolutions.com with the subject line "LAW STUDENT TAX PAPER COMPETITION" (in all caps)

c. The e-mail must attach the following documents:

i. Information Sheet prepared by the entrant in Adobe Acrobat pdf format with the following Information:

A. Title of the paper

B. Name of Student, Law School and Class, Address, Phone Number, and E-Mail Address (please include current and summer contact information)

C. Name of Faculty Sponsor, Address, Phone Number, and E-Mail Address

ii Paper in Microsoft Word or other word processing format

iii. Paper in Adobe Acrobat pdf format

d. Paper must contain a title but should not contain any information which identifies the author, law school, or faculty sponsor

e. Within 5 days of receipt of the submission a confirmation of receipt of the entry will be sent to the entrant and faculty sponsor by e-mail with the information sheet as an attachment

Judging: Papers will be evaluated, and prizes awarded, at the sole discretion of a panel of Tax Section members who will have no knowledge of the author, law school, or sponsor of the papers

Evaluation Criteria without specific weighting:

a. legal analysis

b. legal research

c. organization and writing style

d. originality and relevance of topic to current tax matters

Notification: Winners will be notified no sooner than July 15th and an e-mail will be sent to all entrants shortly after the winners are notified

Publication in *The Texas Tax Lawyer*: The author retains all ownership rights with respect to their work submitted to the competition; however, all top entries will be considered for publication in *The Texas Tax Lawyer* and for posting on the Tax Section website.

Publicity: The names of the winning entrants and their sponsors will be listed on the Tax Section website and may be included in e-mails sent by the Tax Section to Section Members.

Questions: Any questions regarding the competition should be sent by e-mail to donna@clesolutions.com with the subject line "LAW STUDENT TAX PAPER COMPETITION" (in all caps)

THOUGHTS AND QUESTIONS ON THE TAX ASPECTS OF WIND ENERGY

J.F. "Jack" Howell III[1]

Wind energy is quickly becoming big business in the part of Texas west of the Dallas-Fort Worth to San Antonio corridor. I live in Amarillo and my children live in Austin and San Marcos. My in-laws live in Kingsland and the surrounding area. Each time I make the drive, the wind farms from Snyder through Sweetwater and Abilene are larger than the last time I made the drive. My law partner, whose children live in San Angelo, says the same thing each time he makes that drive. Speaking from personal experience, the wind blows even more in the Texas Panhandle than it does in those areas. There are projections for as many as 7,000 wind turbines in the Panhandle. Each turbine can produce as much as 2 megawatts. (A megawatt meets the electricity needs of about 240 homes.) So, it would seem only a matter of time (and transmission lines) before the wind farms in my neck of the woods exceed the size of those in central West Texas. The wind energy production capacity of Texas is already the largest in the nation, and seems destined to grow even larger and at a rapidly increasing rate. Boone Pickens has plans for a 4,000-megawatt wind farm in the northeast Panhandle, which includes plans for privately constructed transmission lines. (That is roughly the equivalent of two Comanche Peak nuclear power plants and enough juice to power several hundred thousand homes.) Wind energy, a renewable or, more likely, constant resource, has the potential to exceed the economic activity that oil and gas, and now water, has and is already pumping into the West Texas economy.

As a result, my firm is being called on more and more to advise land-owners and wind energy developers regarding wind energy activities. That means that I, as a tax practitioner, must begin to understand the tax implications of those activities, whether the practitioners involved in the agreements regarding wind energy development realize the importance of tax planning in those relationships as yet.

When I first began considering the tax implications of wind energy development, I assumed that the property rights and tax aspects of those activities would be analogous to other energy related mineral activities - i.e., oil and gas. However, the more I understand the technology and the relationships involved, the more I become convinced that we will experience the development of an entirely new area of law and related tax law. While oil and gas law and its associated tax law are without a doubt instructive, the analogy is imperfect and may begin to break down as the industry becomes more mature.

There are many considerations that have to be taken into account when advising those involved in wind energy development. The developers, because of the large amounts of capital and financing necessary to develop, build, and operate wind farms (now in the neighborhood of $2 million dollars to simply construct a single wind turbine), are represented by large law firms with their large legal resources. But, landowners who are negotiating with wind energy developers tend to rely on their personal advisors who may be well-versed in real estate law and oil and gas law, but who are just beginning to understand the current implications of the legal attributes of wind development. Most of them are certainly not tax experts. And, even if they were, they might not fully comprehend all of the implications of wind energy, particularly as those implications have not been fully developed as an area of tax practice.

About the only thing we can currently be certain of regarding the tax implications of wind energy, particularly as they apply to landowners, is that the law is uncertain because of the novel concepts involved. What this article hopes to achieve is to first dispel the idea that wind energy deals are the same as mineral energy deals and then to expose some issues where that difference might produce some tax planning opportunities. As I am dealing principally with large concepts in a new area of activities where there is not a lot of decided law, I am not even going to attempt to cite decided law. So, you are not going to see any citations to decided law.

Wind Energy v. Oil and Gas Development

Is wind energy development and production analogous to oil and gas development and production or is it something else?

Mineral exploration, development, and production have a long history under the tax law. Over the years, several tax concepts that are unique to this industry have developed: notably the concept of "economic interest" and the "pool of capital" doctrine. The concept of "economic interest" was introduced into the tax law to determine who is taxable on the mineral income from the property and who is entitled to claim a depletion deduction on mineral production. It is the tax law's way of determining "ownership" of the minerals to be produced from land.

If you are the owner for income tax purposes, you must pay the tax on your share of production. For example, if I am a working interest owner or a royalty owner, my share of production is taxable to me, directly, as my share of production. It is not income to the operator, who then makes a payment to me, resulting in income to me and a deduction to the operator. As a working interest owner or royalty owner, I own part of the "tree" that produces the "fruit." Therefore, I am taxable on the fruit, even though it may actually be harvested by someone else who has been conveyed the legal rights and "ownership" necessary to do so.

So, does this concept have any relevance in the context of wind energy development? It is easy to conclude that since wind is a renewable resource, there is no depletion, and, therefore, no depletion deduction on which the concept of "economic interest" would depend.[2] And, certainly, it is important to know who owns the wind energy rights to know to whom the income from the transfer of those rights is taxable. But "economic interest," at least in the mineral extraction context, may not be the correct concept to apply to determine who is taxable on the income from the energy produced. The income from wind energy production does not accrue from the mining of a natural resource and the selling of that extracted mineral to which title, in Texas, can be held both while it resides in the ground and when it is extracted from the ground. The very concept of what produces the income from wind energy may be very different from that which produces income in mineral production.

While the ultimate result of both oil and gas production and wind energy activities is energy, that is about as close as each of them gets to the other. In the case of oil and gas, there is actual, tangible property that resides under the surface of the ground to which title can be held and conveyed. Oil and gas activities consist of discovering where that property resides, extracting it from the ground, and then selling the now tangible personal property to someone who will use it to make energy or some other product. In Texas, ownership of the oil and gas prior to extraction resides in the owner of the fee simple, unless and until those rights are severed and retained or transferred to someone else. So, the oil and gas itself, and not just the energy that it represents, are property that is owned by someone even before discovery and production, and it continues to be property owned by someone as real estate until it is extracted. Extraction turns the minerals into personal property, but they are still property, title to which can be owned as such.

Certainly there are some similarities here between oil and gas production and wind energy activities; but the differences are striking. And those differences may result in significantly different tax consequences for the parties involved in those activities. Conceptually, the air that sits on a person's land (and goes all the way up to the end of the atmosphere and the beginning of "space") is property just as much as is the gas that resides, initially, under the surface of the land. But the air itself is not acquired as such and sold to produce wind energy. Rather, the energy contained in the flow of the air is harnessed and converted into another type of energy: electricity. That electricity is sold, not the air itself.

So, is this air, or the energy represented by the movement of the air, owned by the fee owner like the gas below the surface is owned by the fee owner? There is, as yet, no clear authority on this subject in Texas. I believe that law regarding water might contain concepts that are applicable to this question.

In the case of water in Texas, the fee owner owns the water under the surface of the land. In fact, subsurface water that does not flow in an underground river or stream is treated just like a mineral or natural resource analogous to oil. But surface water is treated differently. Surface water, except that falling from the sky and captured before it flows into a watercourse, actually belongs to the state. The fee owner has riparian rights to use the surface water for the benefit of the surface estate, but the owner does not hold title to that water. The surface owner also has the right to use any water flowing over his property to produce energy. Thus, for example, a surface owner may construct a water wheel that extracts the energy from flowing water to grind grain. And the surface owner may even, in proper circumstances, construct a dam to capture the hydraulic energy of the water's flow to produce electrical energy.

Applying similar concepts to wind would mean that the air above the fee owner's surface does not actually belong to the fee owner. Rather, the surface owner has rights to the use of the air, and the energy it produces, like a surface owner that abuts a watercourse has riparian rights to use the water and energy in the watercourse. But the surface owner may not actually own title to the air that flows over the surface, only rights to use that air, and the energy it may produce, so long as that use does not infringe on another surface owner's similar rights and does not infringe on the rights of everyone to navigate that air. In fact, there is a long history of surface owners constructing wind mills to use wind energy to pump water from beneath the surface. These wind mills are icons of West Texas. Certainly, no one, as yet, has attempted to impinge those rights by arguing their use somehow infringes on others' similar rights to harvest the energy from the air moving over the surface of the land. On the other hand, there does not appear to he any clearly established law that would grant title to the air to the fee owner under which the air flows. And, so far, our technology has not risen to the point where it would make sense to dispute air ownership one way or the other. It is not yet economical to make such a use of the air flowing over one's land that it could infringe on others' similar rights to make use of that air. You can't yet "capture" air on your land to the extent that it would drain the air or the energy from its flow from other landowners. If one could, would we find that the common law actually gives someone title or rights to do so?

So, what if there is an entire body of common law that has yet to be "made" by our common law judges or our legislature? (The law of "venti an" rights?) If there is, and that's an awfully big and potentially consequential "if," what difference does it make, particularly under today's technologies? It could mean that one does not actually "own" the air and the energy it produces - only the rights to use it if one owns the surface, or at least that part of the surface estate to which those rights attach.[3] Perhaps, practically, it only means that one should not assume that the established laws regarding oil and gas and estates of real property apply to this new economic endeavor. In any case, I will leave the defining of "venti an" rights and estates to the scholars of that subject (or rather to those who become scholars on this new subject).

But I digress. The purpose of this tome is simply to ask whether these concepts would have any tax consequences. Certainly they could. But what would they be? What follows is my current list of wind energy related tax issues. I do not pretend to have the answers yet - only an idea of where the answers may lay. I'm sure I will add to these questions as the wind industry develops, my knowledge increases, and the courts and legislatures begin to provide answers.

Assignment of the "Tree" or the Income the "Tree" Produces

If I assign "wind rights," either for a term of years or in perpetuity, have I actually assigned "property" from which income is produced, or have I simply assigned income from that property?

Here, for federal income tax purposes, the concept of "economic interest" and its related concept of "assignment of income" may be instructive or even applicable. The concept of "economic interest" arose to determine to whom the income from the production of minerals is taxable and whether there is "property" that can be depleted (or amortized or depreciated). Even if the term does not apply to wind energy, the concept does. The income that a property produces, for tax purposes, belongs to the person who owns the property for tax purposes and will be taxed to that person. If a person desires to change to whom the income is taxed, they must assign not only the income but the tax ownership of the property that produces the income. For example, if I own real estate that I lease to another, I cannot simply assign the rent income, and not the property that produces the income, if I am to make the rents taxable to the person to whom I made the assignment - or can I?

So, the preceding discussion of the nature of wind rights under state and federal law may be important in determining whether wind rights may be severed for federal income tax purposes, which may be required before the taxation of the income from those wind rights may be transferred to someone else. That is, if state law will not permit the severance and conveyance or retention of wind rights without any surface ownership, will federal tax law follow state law and tax only the person who owns the surface for the rents produced in a wind lease?

Federal tax law, typically, looks to the rights created under local law to determine the federal tax consequences of those rights, but it does not always follow the labels that local law imposes. Thus, it is possible to have a partnership for federal income tax purposes where one does not exist for state law purposes and vice versa. Likewise, in states where subsurface minerals cannot actually be owned until they are produced, the concept of "economic interest" treats persons as owners even where they may not hold "title" to something under local law. Therefore, it is likely that the severability of wind rights for state law purposes will not govern ownership of wind rights for federal income tax purposes. It will still be necessary, however, to determine who, for federal tax purposes, owns the various properties, or "economic interests," involved in wind production to determine to whom the income produced by the wind energy will be taxed and to determine its character.

While the tax law itself determines to whom income is taxable, the tax law first looks to the rights and duties created by local law, and then applies tax law concepts to those rights and duties. Therefore, if, under Texas law, the ownership rights and duties pertinent to the production of energy from wind cannot be assigned separate from ownership of the surface, it may still be possible under Texas law to create sufficient rights in a non-surface owner such that he is considered an owner of property that produces income for federal tax purposes.

Many of the practitioners in this area recognize this and advise that if one is going to attempt to make a conveyance of "wind rights," that conveyance should describe those rights in detail. But I would also caution practitioners: I have seen some "severances" of "wind rights" and "wind royalties" that only describe the specific types of income that are being assigned. If you do not convey some bundle of rights that is considered property for federal income tax purposes, other than just income, you may not have created something that qualifies as property, or an "economic interest," for tax purposes. If that is the case, you may not have shifted the federal income tax burden.

If you've looked at a wind lease, it is, in essence or economically, just a ground lease with "bonus" rentals based on the income of the lessee from his use of those rights to produce income. That is, the lessee pays to acquire the rights to use, as a lessee and holder of easements (or perhaps usufructs), certain parts of the surface (or the immediate space above the surface and the immediate subsurface) to construct turbines and related gathering and transmission facilities. Regardless of what the payments for use of the land are called, for tax purposes they will be characterized according to how payments for the use of land are taxed. In the case of arrangements for the use of land for periods of less than 30 years, they would probably be most analogous to, and be treated as, rents for real property. (More on treatment of longer term leases later.) *And*, they would probably be treated as such no matter what they are called in the document. That is, even if the documents call them rents, royalties, bonus, etc., they would probably be treated as rents arising from the "sale" of the rights to use the "surface." And they would be taxed to the person who owns the "surface" that is being leased - or would they?

Wind Contracts As Property for Federal Tax Purposes

Certainly, in the case where the owner of the property leased is also the lessor under the lease, the rents produced by the lease would be taxed to the owner/lessor as something in the nature of rents. But what if that owner/lessor assigns the lease (or a portion of it) to someone else? What if the lease is for a term of 50 years, and it is assigned to someone else? What if the assignment of the lease occurs before the lease is even entered into?

The answers to these questions may depend on whether you can sever the rights to wind energy from the surface to create an "economic interest," or the like, in wind energy or a royalty interest in the income produced by the wind energy. They may also depend on whether leases with a term of more than 30 years carry some sort of "ownership" or "economic interest" with them for tax purposes.

There are also issues revolving around long-term leases. The like-kind exchange rules treat leases of real estate with a potential term of 30 years or more as being of a like-kind to ownership estates in real property. There are indications in the sale and leaseback arena that the IRS would like to treat long-term leases as equivalent to ownership of the real estate involved. Most wind leases have terms exceeding 30 years. In fact, it is not unusual for them to have 50-year terms without regard to options to extend. This raises the question of whether, for federal income tax purposes, a 50-year lease is actually a sale of property, rather than a lease, and whether the lease itself is property, separate and apart from ownership of the surface or the thing being leased. If a long-term lease is actually a sale of property, then, instead of a lease producing rental income, I may have entered into an installment sale producing gains and imputed interest income or original issue discount. Such a result would come as a surprise to almost everyone involved; and, with the lack of authority in this new and unique situation, it could be risky to take either position - that the lease is actually a sale or that the lease is actually a lease.

There does seem to be authority, however, for treating the lease, once entered into, as property - at least as property that may be exchanged in a like-kind exchange. And if it may be exchanged in a like-kind exchange, why can't it be sold in a taxable transaction? Or gifted? Why couldn't the rights under such a lease be transferred even before such a lease is entered into and exists? And, if sold, wouldn't any of those properties, if treated as property for tax purposes, qualify for capital gain treatment?

The answers to these questions become even more uncertain when you consider that wind arrangements usually include the grant of easements in addition to the renting of the surface. Easements are generally considered to be real property estates, which may be severed from the fee ownership. How do these additional rights granted affect the characterization of the transaction as a lease or a sale? Or as the creation of an additional "property" that can be bought and sold?

These questions will eventually have answers. And the answers for state law purposes may be different from those for federal income tax purposes. I, personally, find it likely that it will be, and in fact already is, possible to convey a bundle of wind rights for a sufficient period of time that those rights will be considered to be property, or an "economic interest," for federal income tax purposes. But exactly what rights must be conveyed, for what period of time, and in what fashion are, for the time being, undecided.

Royalties

I've now discussed whether the rents from a wind energy deal would be rental income (ordinary income) or gain from the sale of something (presumably capital gain), but what about "royalties"?

Wind leases typically provide for additional payments based, in some fashion, on the income produced by wind energy production. However, unlike oil and gas production, the lessor in a wind transaction doesn't actually own the production - the electricity. Contrast that with the characterization, for tax purposes, of oil and gas production. In oil and gas production, each owner of an "economic interest" is considered to own his share of production (and will, therefore, have to pay tax on his share of the production). So, a royalty in the oil and gas arena is actually considered to be ownership of production. However, in a wind lease, it seems pretty clear that the income is being produced from the sale of electricity - not from the actual sale of wind. Therefore, it would seem to follow that all of the income from the sale of electricity would be taxed to the developer/lessee. Any "royalty" that was paid would be more in the nature of rent that is simply measured by the income-generating activities of the lessee - much like a shopping mall lease.

That conclusion really has no practical effect. That is, the "royalties" would be taxable in the same fashion as any other rent coming due under the arrangement. It is simply semantics. However, when you're dealing with land-owners who are familiar with royalties in the oil and gas context, it may be a disservice to your client to refer to this income as royalties.

There may be, however, a bundle of rights in a wind energy project that is equivalent, or at least analogous, to the rights of royalty holders of oil and gas production. In the oil and gas context, a royalty is the bundle of rights that gives the holder a nonexecutory right to oil and gas production. That bundle of rights is carved out of the mineral estate, and it is considered, for federal income tax purposes, to be an "economic interest," or property. Mightn't there be a similar bundle of wind rights that can be carved out of a larger bundle of rights that, for tax purposes, is considered to be an "economic interest," or property? If so, how "big" does that bundle of rights have to be for it to gain the status of an "economic interest," or property, for federal income tax purposes?

Option payments as deferred income

Many energy deals start with an option to "explore," or study, the wind energy capabilities of land that may be leased. Would these option payments be taxed just as any other option payments?

When, for example, a cash method taxpayer receives money for an option to purchase property, the taxpayer doesn't take that income into account until the option is either exercised or expires. At that time, the character of the consideration, whether it be money or other property, is determined and either included as purchase price (if the option is exercised) or as income (if the option expires).

There is no reason not to suppose that option payments in a wind deal would be treated in the same fashion. But, again, there is no specific authority for such a conclusion.

Ad Valorem Tax Issues

While I've noted for federal income tax purposes that the state law characterization of the wind deal is only indirectly affected by the legal "names" given to wind rights, when it comes to state taxation those "names" have definite tax consequences. What difference does it make for ad valorem tax purposes whether there is actually a wind estate or only "venti an" rights?

If, under Texas law, there is an actual wind estate that, like a mineral estate, can be severed and owned separate from the fee estate, then that estate would probably constitute real estate subject to separate taxation when and if it is severed. In addition, when that estate, even if not severed, begins to add separate value to the ownership of the real estate to which it is appurtenant, it will begin to have an effect on the value of the real estate for ad valorem tax purposes.

If, instead of a wind estate, there are "venti an" rights, does that change the result for ad valorem tax purposes? There is some authority in Texas for the proposition that riparian rights may be severed from the surface ownership to which they attach. If that were the case, then presumably "venti an" rights would be subject to ad valorem taxation in the same fashion as they would if they were art actual wind estate. There is also, however, some authority that indicates that, while severable, riparian rights must still attach to a surface owner that also has riparian rights in the same watercourse. Under this interpretation, "venti an" rights would always simply be something to be valued in valuing whichever surface owner may own "venti an" rights. And, whatever it is that might be conveyed to a person when "wind rights" are conveyed, it is not an estate in real property.

And, what about the value of the property placed on or affixed to the surface by the wind developer/lessee. Prior to the Texas Attorney General issuing its opinion on tax abatement (discussed in a moment), the consensus seemed to be that this property was part of the surface to which it was attached (like a building) and would be taxed to the surface owner as an increase in value to the surface estate's owner. For this reason, wind leases call for the lessee to pay the increase in property taxes imposed on the surface owner by reason of the turbines and other property affixed to the lessor's property. But this is simply a contract right, and does not change the legal liability of the landowner/lessor to pay the taxes attributable to the value of the turbines, etc.

However, the Attorney General appears to believe that, since the surface owner does not own the turbines and other property, these items should be taxed separately to their actual owner. From the standpoint of the surface owner, this is actually a beneficial interpretation. If the wind developer has to pay its own tax on the value of its property, the surface owner does not have to collect the tax from the developer. The government collects its tax directly, and the surface owner doesn't have to rely solely on a contract provision to collect the developer's share of the tax and then pass on that payment to the government.

Tax abatement issues

As mentioned, the Texas Attorney General has issued an opinion treating the wind turbines, etc., as personal property belonging to the wind developer/lessee. The implications of this ruling are fairly wide-reaching. For that reason, if the AG is not persuaded to change his opinion, I think the legislature will probably act to allow abatements on wind turbines, etc.

The AG's opinion was requested in the context of granting a tax abatement to a wind developer. Apparently, one of the landowners was on the body with the power to grant the abatement. The law restricts the makeup of that body to those who are not being granted an abatement. Rather than simply requiring that the landowners resign from the body, an AG's opinion was requested to the effect that the wind turbines, etc., were the only property on which the abatement was to be granted. Those properties belonged to someone other than the member of the commission. Therefore, the law was not violated, as the member of the body was not receiving an abatement.

The AG, in effect, agreed with the outcome regarding the member of the body, but its reasoning prevented the abatement from being granted in the first place. The abatement statute only allows an abatement for real property. The AG found that the wind turbines, etc., since they were owned by someone other than the landowner, were fixtures that would be treated as personal property belonging to the developer and not the surface owner.

Most all wind farms are subject to an ad valorem tax abatement of some sort. This ruling brings all of those abatements into question.

Partnerships between landowners and developers

Could the use of a partnership result in better tax outcome for landowner or wind developer?

Frankly this occurred to me as I was comparing a wind development to a sharing arrangement in the mineral production arena. Sharing arrangements have always struck me as sort of a "frontier" partnership arrangement. And, now, at least in joint operations among "economic interest" holders, they appear to be considered partnerships for tax purposes, to which Subchapter F applies if they do not elect out. I do not think that the typical arrangement between a wind developer and a landowner would be considered a partnership for federal income tax purposes. But might some of the preceding uncertainties be cured by the use of a partnership?

Joint operations of mineral properties are considered partnerships for tax purposes because of the joint operations they undertake - and, perhaps more importantly, because of the joint ownership interests involved. While I, personally, have basically concluded that the owner of the wind rights does have an "economic interest" in those wind rights, I do not think that there is a joint ownership of those rights. Stated another way, the developer makes his income from selling electricity produced by the combination of wind turbines (owned by the developer) and wind (purchased by the developer from the surface owner). The surface owner makes his income from allowing the developer to use his wind. In the case of joint operators in mineral production, they are all considered to own part of the mineral being produced, and their joint income comes from the sale of that j ointly owned mineral.

Nonetheless, it is possible that a wind developer and a landowner could be considered to be a partnership for tax purposes, particularly where the lease is for a long term. After all, the use of property for 50 years does start to look like an equity contribution to a joint enterprise, rather than a lease allowing the use of property to a lessor.

But even if the arrangement is not already considered a partnership for tax purpose, should the landowner and developer consider a partnership arrangement instead of a landlord/tenant arrangement? I don't think that this question can be answered (or even discussed in any detail) here. Partnership taxation has many consequences and might require many local law consequences that are unacceptable to the parties. So, I simply raise the question for now.

One should also consider whether, apart from the possible forced or voluntary partnership of the parties to the entire wind development, a partnership produces certainty out of uncertainty when attempts are made to carve out differing rights to the lessor's income in a wind energy development. Partnership tax law certainly provides more certainty than the questions of what bundles of rights actually create property for tax purposes. Is there a benefit of sounder footing for tax purposes if one were to convey all surface rights, including "venti an" rights, to a partnership that allocates income in whatever fashion is desired (within the strictures of "substantial economic effect"), and then to convey partnership interests in the partnership to reach the desired economic division of those rights, rather than attempting to "carve out" those income rights from the real estate?

The Future

Since all I've done here is raise questions, I don't think that I can have a "Conclusion." I hope that in the future some of these questions will find authoritative answers. Whatever the answers tum out to be, there will be planning possibilities in the right circumstances.

In order to help push that process along, I have posted this article to my blog at: http://taxlaw.sprouselaw.com/2008/041articleshnore-detailed-discussions/thoughts-andguestions-on-the-tax-aspects-of-wind-energy/. If you have comments, information, speculation, additional questions, or answers, please post them there.

ENDNOTES

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2 Although, it would certainly be possible that the acquisition costs of wind energy property would be amortizable, even if not depletable.

3 If that is the case, it raises at least one interesting question regarding the use of technology that has already been developed to "store" wind energy for sale at the times that energy use is most needed. Wind farms tend to produce the largest amount of electricity at night. (Contrary to our common observations, the wind blows more at night than during the day at the elevation that wind turbines operate.) But the demand for electricity is highest during the day. Technology now exists that allows one to "store" the energy produced by the wind at night in underground reservoirs. The wind harvested at night is used to compress air. When the compressed air is released, it is run through electricity generating turbines. Thus, the energy produced by wind at night can be turned into electricity by day.

If the surface owner does not own the air, then is it conversion or the like for the surface owner to capture the air above the surface of the fee and store it underground? Does it then belong to the surface owner or the mineral owner? Or does the surface owner actually own the air once captured, even though he doesn't own it in its natural state?

PRICING YOUR SERVICES: LEGAL FEE ISSUES FOR SMALL AND SOLO TAX LAW FIRMS

Christina A. Mondrik[1]

The paper discusses legal fee issues for tax attorneys, including a discussion of the legal ethical requirements, interim IRS guidance on contingency fees and determining appropriate billing rates/fee arrangements.

The Texas Disciplinary Rules of Professional Conduct address fees in Rule 1.04. The primary rule is that "a lawyer shall not enter into an arrangement for, charge, or collect an illegal fee or unconscionable fee."[2] The rules consider a fee to be unconscionable using a "reasonable competent lawyer standard." If a competent lawyer could not form a reasonable belief that the fee is reasonable, then it is considered to be unconscionable.

These and other guidelines in the Texas Disciplinary Rules of Professional Conduct are useful for effectively structuring fee agreements and communicating them to clients. Effectively communicated, agreed-upon fee structures and detailed invoices help attorneys to not only avoid ethical and malpractice problems involved in fee arrangements, but also help to improve the likelihood that billed legal fees will be collected.

Source of Fees

In the area of tax law, there are additional concerns regarding legal fees, particularly in cases involving tax shelters, eggshell cases or borderline criminal investigations. In such cases, the initial client interview is an important tool, not only to evaluate the strength of the case but also the integrity of the client. Regardless of whether your client checks the "smell test" for integrity, it's still important to consider the form of the payment for legal fees. If a client is charged with committing a crime, whether tax-related or not, a taxpayer paying for legal fees in cash may implicate the lawyer in a conspiracy charge regarding alleged laundering of illegal source income.[3] Therefore, it's advisable for tax attorneys to require payments by check or credit card, rather than allowing clients to pay in cash or to wire funds to the law firm's account.

Factors

Generally the concept of an unconscionable fee involves one that is inappropriate under the circumstances. The Texas Rules of Professional Conduct provide the following factors, which an attorney may considered in determining the reasonableness of a fee:[4]

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
(3) the fee customarily charged in the locality for similar legal services;
(4) the amount involved and the results obtained;
(5) the time limitations imposed by the client or by the circumstances;
(6) the nature and length of the professional relationship with the client;
(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and
(8) whether the fee is fixed or contingent on results obtained or uncertainty of collection before the legal services have been rendered.

Many large firms charge higher fees for tax services than they do for other legal services. Since the practice of tax law involves an application of a sophisticated body of knowledge, many firms view tax law services as premium services which are not to be discounted. These large firms tend to perform tax law services in connection with large transactions or major litigation.

Smaller and mid-sized firms generally perform a wider variety of tax law services, including not only planning and litigation but also tax controversy matters and collection cases. These matters often require a bit more discretion in determining the appropriate fee. Determining a proper fee requires an attorney to consider the interests of both client and lawyer. Tax attorneys should consider all of the relevant factors before deciding the appropriate fee for taking a case, including not only the client's ability to pay but also the level of risk involved, the amount of work to be performed and the likelihood that the client will be able to assist the attorney in compiling the necessary exhibits, financial records and other documents needed to support the case.

Firms involved in the recent tax shelter cases have been criticized for charging substantial fees for legal opinions in transactions that the IRS later identified as abusive tax avoidance transactions.[5] Some attorneys in the industry have commented that the size of the fees collected for such work served to entice tax professionals into behavior outside the realm of what they would normally consider prudent.

Engagement Letters

The Texas Rules of Professional Conduct counsel that a lawyer who has not regularly represented a client, should communicate the basis or rate of the legal fee, preferably in writing, before or within a reasonable time after commencing the representation.[6] This is a good practice with any client. Written engagement letters and written conclusion letters serve several purposes including:

- Establishing a distinct commencement and conclusion of the attorney-client relationship
- Establishing clear billing and rate expectations
- Establishing the expectation that basis for the fees (i.e. the work performed) is to be clearly documented to the client, in writing, during the billing period
- Establishing the expectation that the client is to pay the fees upon receipt of each invoice
- Reducing the likelihood of confusion or disputes regarding the fee charged in a particular case
- Providing a basis for enforcing collection of fees in the event a client doesn't pay the amount invoiced

As the Comments to the Rules point out, "[a] written statement concerning the fee reduces the possibility of misunderstanding, and when the lawyer has not regularly represented the client it is preferable for the basis or rate of the fee to be communicated to the client in writing. Furnishing the client with a simple memorandum or a copy of the lawyer's customary fee schedule is sufficient if the basis or rate of the fee is set forth."

The engagement letter also generally establishes the amount of the retainer, if any, and the procedures under which the retainer may be applied. Some attorneys apply the retainer to the fees as they are incurred. Other attorneys use what has been called the "evergreen" retainer approach. Under this approach, the retainer remains in trust until the conclusion of the engagement and is refunded to the client after all legal fees have been paid. Other, hybrid approaches, involve flat fee billing (i.e. a flat rate for a particular type of work) or billing against the retainer until it reaches a certain level and then requesting that the retainer be refreshed by another check to be applied toward the IOLTA account.

The Texas Rules of Professional Conduct provide guidelines for retainers, including the maintenance of an IOLTA account. The State of Texas sweeps the interest earned on the IOLTA accounts into a fund for providing legal services to the poor. The specific guidelines for retainers and IOLTA accounts are beyond the scope of this discussion.

Additional information regarding Communications Concerning a Lawyer's Services is attached hereto as Exhibit B. These rules require that other communications, including advertising, be clear and not misleading. This is particularly important for tax practitioners, who may be tempted to compete with consultants advertising "pennies on the dollar" settlements with the Internal Revenue Service.

New Matters for Old Clients

Just as it is prudent to issue a conclusion letter when a matter has been accomplished, it is equally prudent to issue a new engagement letter when a new matter commences. The Comments to the Texas Rules of Professional Conduct acknowledge that a lawyer who has regularly represented a client will ordinarily have evolved an understanding concerning the basis or rate of the fee. The comments provide guidelines under which the fee to be charged should be re-communicated to the client.

If the basis or rate of fee charged to a regularly represented client differs from the understanding that has evolved, the lawyer should advise the client of the change. For example, when the billing rates for firm members change, a memo should go out to all clients informing them in advance of the change.

In a new attorney-client relationship, it's very important to develop an understanding as to the fee in the initial communication, whether it be a face-to-face meeting or a telephone conference. The fee should be reiterated in writing, to prevent any misunderstandings. The comments to the Rules advise that an attorney need not recite all of the factors underlying the basis for the fee, but only those that are directly involved in its computation. "It is sufficient, for example, to state that the basic rate is an hourly charge or a fixed amount or an estimated amount, in order to identify the factors that may be taken into account in finally fixing the fee."

Some clients will request fee estimates or ranges for various parts of the project (e.g., audit / appeals / litigation). When developments that occur during the representation render an earlier estimate substantially inaccurate, the attorney should provide a revised estimate to the client.

Contingent Fees

The Texas Rules of Professional Conduct allow contingent fees in matters other than those that involve representing a defendant in a criminal case or those that are prohibited by other law.[7] A contingency fee is one that is contingent on the outcome of the matter for which the service is rendered.

For contingency fee cases, the agreement must be in writing. The contingent fee agreement shall state the method by which the fee is to be determined. A common method is a percentage of recovery. For example, in a tax refund case, an attorney may charge a percentage of the amount of tax, penalty and interest recovered in connection with the claim.

If the fee arrangement provides different percentage that accrue to the lawyer in the event of settlement, trial or appeal, the percentage for each shall be stated in the agreement. The agreement shall also state the litigation and other expenses to be deducted from the recovery, and whether such expenses are to be deducted before or after the contingent fee is calculated. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement describing the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

The IRS recently issued interim guidance clarifying when tax practitioners may charge a contingent fee under Circular 230.[8] A copy of Notice 2008-43 is attached hereto as Exhibit A. For arrangements entered into after Mar. 26, 2008, final regulations provide that a practitioner may not generally charge a contingent fee for services rendered in connection with any matter before IRS.[9] The IRS provides some exceptions to this rule. One of the exceptions allows contingent fees for services rendered in connection with IRS examinations of, or challenges to, (1) an original tax return; or (2) an amended return or claim for refund or credit filed within 120 days of the date the taxpayer receives written notice of the examination of, or challenge to, the original tax return.[10]

Fee Sharing

The Texas Rules of Professional Conduct provide guidelines for sharing fees among lawyers who are not in the same firm. The Rules prohibit the division of a fee or the arrangement for the division of a fee between lawyers who are not in the same firm unless the division of fees is (1) in proportion to the professional services each lawyer performs; or (2) the division is made between lawyers who assume joint responsibility for the representation.

In any case, the Rules require a client's prior consent in writing. The client must consents in writing to the terms of the arrangement before the association commences or referral is proposed. The disclosure must include the following information:

(i) the identity of all lawyers or law firms who will participate in the fee-sharing arrangement, and
(ii) whether fees will be divided based on the proportion of services performed or by lawyers agreeing to assume joint responsibility for the representation, and
(iii) the share of the fee that each lawyer or law firm will receive or, if the division is based on the proportion of services performed, the basis on which the division will be made.

The other requirements of legal fees also continue to apply, including the prohibitions against illegal or unconscionable fees.

The Rules go on to say that a client's consent to fee sharing agreement or a referral agreement must be an informed consent. Otherwise the lawyer or law firm may not associate other counsel in the representation, or to the client to other counsel for such representation. Uninformed consent does not constitute a valid confirmation.

"No attorney shall collect or seek to collect fees or expenses in connection with any such agreement that is not confirmed in that way, except for:

(1) the reasonable value of legal services provided to that person; and
(2) the reasonable and necessary expenses actually incurred on behalf of that person."

The Rules do provide an exception for payments to former partners or associates pursuant to separation or retirement agreements. There is also an exception for the State Bar of Texas lawyer referral program, which is established in accordance with the Texas Lawyer Referral Service Quality Act.[11] Additional information regarding fee-sharing, particularly the prohibition against fee-sharing with non-lawyers, is attached hereto as <u>Exhibit C</u>.

<u>Types of Fees</u>

A variety of fee computation methods may be applicable in tax law cases. A few of the common legal fee methods include:

Percentage fees and contingent fees (which may vary in accordance with the amount at stake or recovered);
Hourly rates;
Flat fee arrangements; or
Any combination of the above-referenced methods.

Where more than one type of fee structure may be appropriate, the lawyer should discuss the alternative fee bases with the client and explain the implications of each.

The Comments to the Texas Rules of Professional Conduct warn against abuse of a fee method: "Once a fee arrangement is agreed to, a lawyer should not handle the matter so as to further the lawyer's financial interests to the detriment of the client. For example, a lawyer should not abuse a fee arrangement based primarily on hourly charges by using wasteful procedures."

<u>Rates of Fees</u>

A lawyer's fees may vary according to many factors. A few of the relevant considerations include:

- the time required,
- the lawyer's experience,
- the lawyer's ability
- the lawyer's and the firm's reputation,
- the nature of the employment,
- the responsibility involved, and
- the results obtained.

In tax matters, it's often also important to consider what portion of the work is appropriate for the client, legal assistants, enrolled agents, CPAs or others to assist in preparation. It's also important to consider the attorney's credentials, such as board certification, and the relative perceived value of these credentials.

How do you know if your rate is too high? This is easy. Clients will seem interested in having your firm perform the work but then may back away or seek to negotiate when confronted with the fee rate that you're presenting.

How do you know if your rate is too low? This is more difficult. If you're having difficulty paying the bills, that's a good sign that your costs are too high or your rates are too low. Otherwise, it's more difficult to identify when you're undercutting your services – clients generally won't complain about too low of a rate on the bills. However, they may provide subtle indications, such as calling for frequent conference calls on each detailed aspect of the case, which indicate that your rate may be a little too much of a bargain. Surprisingly, raising your rate to an appropriate amount may improve your clients' perceived value of your services and actually increase your collection percentages.

<u>Billing</u>

Accurate, timely billing statements, that detail the work performed, will also assist in the collection of fees from your clients. Clients should know when to expect their invoices and should understand your policies regarding the retainer. If you lay down your expectations at the commencement of the work, it's more likely that your clients will live up to those expectations by timely paying your fees.

<u>Pro Bono and Reduced Fee Work</u>

The Comments to the Rules provide that a lawyer may charge less than a conscionable fee or no fee at all. The comments also acknowledge: "The determination of the reasonableness of a fee, or of the range of reasonableness, can be a difficult question, and a standard of reasonableness is too vague and uncertain to be an appropriate standard in a disciplinary action." Therefore, lawyers are subject to discipline only for illegal fees or unconscionable fees.[12]

The Texas Rules of Professional Conduct also state that "[a] lawyer should render public interest legal service. The basic responsibility for providing legal services for those unable to pay ultimately rests upon the individual lawyer, and personal involvement in the problems of the disadvantages can be one of the most rewarding experiences in the life of a lawyer. Every lawyer, regardless of professional prominence or professional workload, should find time to participate in or otherwise support the provision of legal services to the disadvantaged. The provision of free legal services to those unable to pay reasonable fees is a moral obligation of each lawyer as well as the profession generally. A lawyer may discharge this basic responsibility by providing public interest legal services without fee, or at a substantially reduced fee, in one or more of the following areas: poverty law, civil rights law, public rights law, charitable organization representation, the administration of justice, and by financial support for organizations that provide legal services to persons of limited means."

In the area of tax law, there are many opportunities for providing pro bono services, including tax law clinics, VITA programs, assistance at U.S. Tax Court calendars, and other opportunities. Often these programs are good opportunities for new solo or small firm attorneys to gain experience while assisting the underprivileged with much needed legal services.

Exhibit A

Notice 2008-43, 2008-15 IRB 748, 03/26/2008

Practice before IRS—contingent fee arrangements; interim guidance.

Headnote:

In response to requests of practitioners after publication of final Circular 230 regs in late 2007, IRS has clarified that it will allow practitioners to charge contingent fees for services rendered with regard to examination or challenge of taxpayer's original return or amended return or claim for refund or credit *filed before taxpayer received written notice of examination or challenge*, or is filed no later than 120 days after written notice or written challenge is received. Practitioners were concerned that initial "within 120 days" language as reflected in final regs required IRS to first furnish written notice of examination before practitioner could charge contingent fee. IRS will also permit contingent fee arrangement in whistleblower claims under Code Sec. 7623;.

Reference(s): ¶ 76,559.82(10);

Full Text:

This notice provides guidance to practitioners concerning contingent fees under Treasury Department Circular No. 230, 31 C.F.R. part 10 (Circular 230). Specifically, this notice provides interim guidance clarifying when a practitioner may charge a contingent fee under section 10.27(b)(2) of Circular 230 for services rendered in connection with any matter before the Internal Revenue Service.

The Treasury Department and the IRS intend to revise section 10.27 to reflect the clarifications described in this notice. The IRS will follow the interim rules in this notice for purposes of enforcing section 10.27 until further guidance is provided.

Background

In general, 31 U.S.C. section 330 authorizes the Secretary to regulate attorneys, certified public accountants, enrolled agents, enrolled actuaries, and others who practice before the Service. Regulations under section 330 are promulgated in 31 C.F.R. part 10 and are reprinted as Treasury Department Circular No. 230.

On September 26, 2007, the Treasury Department and the IRS published final regulations in the **Federal Register** (72 FR 54540) modifying rules governing the general standards of practice before the IRS. These final regulations generally preclude a practitioner from charging a contingent fee for services rendered in connection with any matter before the Internal Revenue Service, including the preparation or filing of a tax return, amended tax return or claim for refund or credit.

The final regulations, however, permit a practitioner to charge a contingent fee for services rendered in connection with the IRS examination of, or challenge, to (i) an original tax return, or (ii) an amended return or claim for refund or credit when the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return. Contingent fees are also permitted for interest and penalty reviews and for services rendered in connection with a judicial proceeding arising under the Internal Revenue Code. The final amendments to section 10.27 made by the final regulations apply to fee arrangements entered into after March 26, 2008.

Section 406 of the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432 (120 Stat. 2958) (the Act), which was enacted on December 20, 2006, amended section 7623 of the Internal Revenue Code concerning the payment of awards to certain persons who detect underpayments of tax. Prior statutory authority to pay awards at the discretion of the Secretary was re-designated as section 7623(a), and a new section 7623(b) was added to the Code. Additional off-Code provisions in section 406 of the Act established a Whistleblower Office within the IRS and addressed reward program administration issues. See Notice 2008-4, 2008-2 I.R.B. 253, for interim guidance applicable to award claims submitted under the authority of section 7623(b).

Interim Guidance

Several practitioners have contacted the Treasury Department and the IRS to request a clarification of the exception in section 10.27(b)(2)(ii) of Circular 230 permitting a practitioner to charge a contingent fee for services rendered in connection with an IRS examination of, or challenge, to an amended return or claim for refund or credit when the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return. Specifically, the practitioners are concerned that the "within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return" language in section 10.27(b)(2)(ii) requires the IRS to furnish the written notice of examination to a taxpayer as a prerequisite to a practitioner charging a contingent fee. Other practitioners contacted the Treasury Department and the IRS to discuss whether section 10.27 permits practitioners to charge a contingent fee with respect to whistleblower claims under section 7623.

In response to these requests, the Treasury Department and the IRS have determined that section 10.27(b)(2) should be clarified and amended. Accordingly, the IRS will apply the following interim rules as revised below under section 10.27(b)(2) until the Treasury Department and the IRS amend the regulations:

§ 10.27 Fees.

*****

(b) ***

(2) A practitioner may charge a contingent fee for services rendered in connection with the Service's examination of, or challenge to—

(i) An original tax return; or

(ii) An amended return or claim for refund or credit filed before the taxpayer received a written notice of examination of, or a written challenge to, the original tax return; or filed no later than 120 days after the receipt of such written notice or written challenge. The 120 days is computed from the earlier of a written notice of the examination, if any, or a written challenge to the original return.

(3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.

(4) A practitioner may charge a contingent fee for services rendered in connection with a claim under section 7623 of the Internal Revenue Code.

(5) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

*****

Effective Date For Interim Guidance

These interim rules regarding contingent fees are applicable to fee arrangements entered into after March 26, 2008.

Drafting Information

The principal author of this notice is Matthew S. Cooper of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this notice contact Matthew S. Cooper at 202-622-4940 (not a toll-free call).

Exhibit B

Rule 7.02 Communications Concerning a Lawyer's Services

(a) A lawyer shall not make or sponsor a false or misleading communication about the qualifications or the services of any lawyer or firm. A communication is false or misleading if it:

(1) contains a material misrepresentation of fact or law, or omits a fact necessary to make the statement considered as a whole not materially misleading;

(2) contains any reference in a public media advertisement to past successes or results obtained unless

(i) the communicating lawyer or member of the law firm served as lead counsel in the matter giving rise to the recovery, or was primarily responsible for the settlement or verdict,

(ii) the amount involved was actually received by the client,

(iii) the reference is accompanied by adequate information regarding the nature of the case or matter and the damages or injuries sustained by the client, and

(iv) if the gross amount received is stated, the attorney's fees and litigation expenses withheld from the amount are stated as well;

(3) is likely to create an unjustified expectation about results the lawyer can achieve, or states or implies that the lawyer can achieve results by means that violate these rules or other law;

(4) compares the lawyer's services with other lawyers' services, unless the comparison can be substantiated by reference to verifiable, objective data;

(5) states or implies that the lawyer is able to influence improperly or upon irrelevant grounds any tribunal, legislative body, or public official;

(6) designates one or more specific areas of practice in an advertisement in the public media or in a solicitation communication unless the advertising or soliciting lawyer is competent to handle legal matters in each such area of practice; or

(7) uses an actor or model to portray a client of the lawyer or law firm.

(b) Rule 7.02(a)(6) does not require that a lawyer be certified by the Texas Board of Legal Specialization at the time of advertising in a specific area of practice, but such certification shall conclusively establish that such lawyer satisfies the requirements of Rule 7.02(a)(6) with respect to the area(s) of practice in which such lawyer is certified.

(c) A lawyer shall not advertise in the public media or state in a solicitation communication that the lawyer is a specialist except as permitted under Rule 7.04.

(d) Any statement or disclaimer required by these rules shall be made in each language used in the advertisement or solicitation communication with respect to which such required statement or disclaimer relates; provided however, the mere statement that a particular language is spoken or understood shall not alone result in the need for a statement or disclaimer in that language.

Comment

1. The Rules within Part VII are intended to regulate communications made for the purpose of obtaining professional employment. They are not intended to affect other forms of speech by lawyers, such as political advertisements or political commentary, except insofar as a lawyer's effort to obtain employment is linked to a matter of current public debate.

2. This Rule governs all communications about a lawyer's services, including advertisements regulated by Rule 7.04 and solicitation communications regulated by Rules 7.03 and 7.05. Whatever means are used to make known a lawyer's services, statements about them must be truthful and nondeceptive.

3. Sub-paragraph (a)(1) recognizes that statements can be misleading both by what they contain and what they leave out. Statements that are false or misleading for either reason are prohibited.

A truthful statement is misleading if it omits a fact necessary to make the lawyer's communication considered as a whole not materially misleading. A truthful statement is also misleading if there is a substantial likelihood that it will lead a reasonable person to formulate a specific conclusion about the lawyer or the lawyer's services for which there is no reasonable factual foundation.

4. Sub-paragraphs (a)(2) and (3) recognize that truthful statements may create "unjustified expectations" For example, an advertisement that truthfully reports that a lawyer obtained a jury verdict of a certain amount on behalf of a client would nonetheless be misleading if it were to turn out that the verdict was overturned on appeal or later compromised for a substantially reduced amount, and the advertisement did not disclose such facts as well. Even an advertisement that fully and accurately reports a lawyer's achievements on behalf of clients or former clients may be misleading if presented so as to lead a reasonable person to form an unjustified expectation that the same results could be obtained for other clients in similar matters without reference to the specific factual and legal circumstances of each client's case.

Those unique circumstances would ordinarily preclude advertisements in the public media and solicitation communications that discuss the results obtained on behalf of a client, such as the amount of a damage award, the lawyer's record in obtaining favorable settlements or verdicts, as well as those that contain client endorsements.

5. Sub-paragraph (a)(4) recognizes that comparisons of lawyers' services may also be misleading unless those comparisons "can be substantiated by reference to verifiable objective data." Similarly, an unsubstantiated comparison of a lawyer's services or fees with the services or fees of other lawyers may be misleading if presented with such specificity as would lead a reasonable person to conclude that the comparison can be substantiated. Statements comparing a lawyer's services with those of another where the comparisons are not susceptible of precise measurement or verification, such as "we are the toughest lawyers in town", "we will get money for you when other lawyers can't", or "we are the best law firm in Texas if you want a large recovery" can deceive or mislead prospective clients.

6. The inclusion of a disclaimer or qualifying language may preclude a finding that a statement is likely to create unjustified expectations or otherwise mislead a prospective client, but it will not necessarily do so. Unless any such qualifications and disclaimers are both sufficient and displayed with equal prominence to the information to which they pertain, that information can still readily mislead prospective clients into believing that similar results can be obtained for them without reference to their specific factual and legal circumstances. Consequently, in order not to be false, misleading, or deceptive, other of these Rules require that appropriate disclaimers or qualifying language must be presented in the same manner as the communication and with equal prominence. See Rules 7.04 (q) and 7.05(a) (2).

7. On the other hand, a simple statement of a lawyer's own qualifications devoid of comparisons to other lawyers does not pose the same risk of being misleading so does not violate sub-paragraph (a)(4). Similarly, a lawyer making a referral to another lawyer may express a good faith subjective opinion regarding that other lawyer.

8. Thus, this Rule does not prohibit communication of information concerning a lawyer's name or firm name, address and telephone numbers; the basis on which the lawyer's fees is determined, including prices for specific services and payment and credit arrangements; names of references and with their consent, names of clients regularly represented; and other truthful information that might invite the attention of those seeking legal assistance. When a communication permitted by Rule 7.02 is made in the public media, the lawyer should consult Rule 7.04 for further guidance and restrictions. When a communication permitted by Rule 7.02 is made by a lawyer through a solicitation communication, the lawyer should consult Rules 7.03 and 7.05 for further guidance and restrictions.

9. Sub-paragraph (a)(5) prohibits a lawyer from stating or implying that the lawyer has an ability to influence a tribunal, legislative body, or other public official through improper conduct or upon irrelevant grounds. Such conduct brings the profession into disrepute, even though the improper or irrelevant activities referred to are never carried out, and so are prohibited without regard to the lawyer's actual intent to engage in such activities.

<u>Exhibit C</u>

Rule 5.04 Professional Independence of a Lawyer

(a) A lawyer or law firm shall not share or promise to share legal fees with a non-lawyer, except that:

(1) an agreement by a lawyer with the lawyer's firm, partner, or associate, or a lawful court order, may provide for the payment of money, over a reasonable period of time, to the lawyer's estate to or for the benefit of the lawyer's heirs or personal representatives, beneficiaries, or former spouse, after the lawyer's death or as otherwise provided by law or court order.

(2) a lawyer who undertakes to complete unfinished legal business of a deceased lawyer may pay to the estate of the deceased lawyer that proportion of the total compensation which fairly represents the services rendered by the deceased lawyer; and

(3) a lawyer or law firm may include non-lawyer employees in a retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement.

(b) A lawyer shall not form a partnership with a non-lawyer if any of the activities of the partnership consist of the practice of law.

(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.

(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;

(2) a nonlawyer is a corporate director or officer thereof; or

(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

Comment:

1. The provisions of Rule 5.04(a) express traditional limitations on sharing legal fees with nonlawyers. The principal reasons for these limitations are to prevent solicitation by lay persons of clients for lawyers and to avoid encouraging or assisting nonlawyers in the practice of law. See Rules 5.04(d), 5.05 and 7.03. The same reasons support Rule 5.04(b).

2. The exceptions stated in Rule 5.04(a) involve situations where the sharing of legal fees with a nonlawyer is not likely to encourage improper solicitation or unauthorized practice of law. For example, it is appropriate for a law firm agreement to provide for the payment of money after the death of a lawyer, or after the establishment of a guardianship for an incapacitated lawyer, to the estate of or to a trust created by the lawyer. A court order, such as a divorce decree, may provide, when appropriate, for the division of legal fees with a nonlawyer. Likewise, the inclusion of a secretary or nonlawyer office administrator in a retirement plan to which the law firm contributes a portion of its profits or legal fees is proper because this division of legal fees is unlikely to encourage improper solicitation or unauthorized practice of law.

3. Rule 5.04(a) forbids only the sharing of legal fees with a nonlawyer and does not necessarily mandate that employees be paid only on the basis of a fixed salary. Thus, the payment of an annual or other bonus does not constitute the sharing of legal fees if the bonus is neither based on a percentage of the law firms profits or on a percentage of particular legal fees nor is given as a reward for conduct forbidden to lawyers. Similarly, the division between lawyer and client of the proceeds of a settlement judgment or other award in which both damages and attorney fees have been included does not constitute an improper sharing of legal fees with a nonlawyer.

Reimbursement by a lawyer made to a bona fide or pro bono legal services entity for its reasonable expenses in connection with the matter referred to or being handled by the lawyer does not constitute a division of legal fees within the meaning of Rule 5.04.

4. Because the lawyer-client relationship is a personal relationship in which the client generally must trust the lawyer to exercise appropriate professional judgment on the client's behalf, Rule 5.04(c) provides that a lawyer shall not permit improper interference with the exercise of the lawyers professional judgment solely on behalf of the client. The lawyer's professional judgment should be exercised only for the benefit of the client free of compromising influences and loyalties. Therefore, under Rule 5.04(c) a person who recommends, employs, or pays the lawyer to render legal services for another cannot be permitted to interfere with the lawyer's professional relationship with that client. Similarly, neither the lawyers personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute the lawyer's loyalty to the client.

5. Because a lawyer must always be free to exercise professional judgment without regard to the interests or motives of a third person, the lawyer who is employed or paid by one to represent another should guard constantly against erosion of the lawyers professional judgment. The lawyer should recognize that a person or organization that pays or furnishes lawyers to represent others possesses a potential power to exert strong pressures against the independent judgment of the lawyer. The lawyer should be watchful that such persons or organizations are not seeking to further their own economic, political, or social goals without regard to the lawyer's responsibility to the client. Moreover, a lawyer employed by an organization is required by Rule 5.04(c) to decline to accept direction of the lawyer's professional judgment from any nonlawyer in the organization.

6. Rule 5.04(d) forbids a lawyer to practice with or in the form of a professional corporation or association in certain specific situations where erosion of the lawyer's professional independence may be threatened. The danger of erosion of the lawyer's professional independence sometimes may exist when a lawyer practices with associations or organizations not covered by Rule 5.04(d). For example, various types of legal aid offices are administered by boards of directors composed of lawyers and nonlawyers, and a lawyer should not accept or continue employment with such an organization unless the board sets only broad policies and does not interfere in the relationship of the lawyer and the individual client that the lawyer serves. See Rule 1.13. Whenever a lawyer is employed by an organization, a written agreement that defines the relationship between the lawyer and the organization and that provides for the lawyers professional independence is desirable since it may serve to prevent misunderstanding as to their respective roles.

ENDNOTES

1 Mondrik & Associates, 512-542-9300, cmondrik@mondriklaw.com.
2 Rule 1.04(a) Fees (Effective March 1, 2005).
3 See discussion of Klein conspiracy cases in *U.S. v. Klein*, 247 F.2d 908 (2nd Cir. 1957).
4 Rule 1.04 (b).
5 Consider KPMG settlement with Justice Department, imposing a $456 million penalty, $128 million of which represented consulting fees the firm earned on the transactions. *See also Denney, et al v. Jenkens & Gilchrist, P.C.* (S.D.N.Y Docket 2005-3434).
6 Rule 1.04 (c).
7 Rule 1.04 (d) and (e).
8 Notice 2008-43, 2008-15 IRB
9 Treas. Reg. § 10.27(b)(1).
10 Treas. Reg. § 10.27(b)(2).
11 *See* Tex. Occ. Code 952.001 et seq., (or any amendments or recodifications thereof).
12 "Paragraph (a) defines an unconscionable fee in terms of the reasonableness of the fee but in a way to eliminate factual disputes as to the fees reasonableness. The Rules unconscionable standard, however, does not preclude use of the reasonableness standard of paragraph (b) in other settings."

DRILLING DOWN THE TEXAS MARGIN TAX: A GUSHER OR DRY HOLE OF TAXES FOR THE OIL & GAS INDUSTRY?

Jeff Slade[1]

The oil and gas industry faces a new hurdle in navigating around the Texas franchise tax (also commonly referred to as the "margin tax"). Traditionally, investors and mineral operators were organized as limited partnerships to avoid the franchise tax. However, the new tax applies to virtually all entities, including limited partnerships and most trusts (other than certain grantor trusts). Although there has been a general alarm about the new tax, several provisions of the tax provide favorable treatment to oil and gas investors and operators and careful tax planning could result in substantial tax savings.

General Overview

Although the State of Texas vigorously defends its position that the margin tax *is* not a net income tax (which would violate the Texas Constitution), for all practical purposes, the margin tax is, in effect, a veiled income tax. A taxable entity's tax base is its total revenue (which is generally based on its federal gross income). The entity is entitled to deduct the greater of 30% of its total revenue, its cost of goods sold, or its compensation. After taking the applicable deduction, the resulting amount is "apportioned" to Texas (<u>i.e.</u>, its total revenue, as reduced by the deduction, is multiplied by a ratio equal to the entity's Texas gross receipts, divided by the entity's total gross receipts) and a 1% tax is imposed. Depending on the entity's total revenue, it may qualify for discounts (as further discussed below). Additionally, in certain limited cases where an entity's total revenue is not greater than $10 million, the entity may elect to use a reduced 0.575% tax rate, although the entity may not utilize the deduction for either compensation or cost of goods sold.

Passive Entities

One of the most valuable provisions available to the oil and gas industry is the exemption for "passive entities." An entity will be considered a passive entity if at least 90% of its federal gross income is attributable to passive income. Among those items that are considered passive are royalties and bonuses from mineral properties, net *capital* gains from the sale of real property, delay rental income and income from other non-operating mineral interests. Other traditionally passive sources are also considered passive income, such as dividends, interest, and net gains from the sale of commodities or securities.

Two items that are specifically excluded from being considered passive income are (1) rental income (but not delay rental income) and (2) income received by a non-operator from mineral properties under a joint operating agreement if such non-operator is part of an affiliated group with the operator under the joint operating agreement. The latter exclusion is intended to prevent an operator from allocating a portion of the fee it would receive to a non-operator that is affiliated with the operator. In other words, if a non-operator receives income from a joint venture and the operator is affiliated with such non-operator, the non-operator's income from the joint venture is not passive.

So, can an active operator can just transfer all of its passive ownership activities into a subsidiary to exempt the income? Not exactly.

Generally, a taxable entity that receives distributions from a passive entity must include those distributions in the taxable entity's margin tax calculation. This requires a careful review of the entire ownership structure. If at any point there is a taxable entity that owns a direct or indirect interest in the passive entity, there is a strong likelihood that the distributions from the passive entity will be subject to tax at some upper-tier level. However, if the passive entity is owned by individuals or entities that are exempt from the margin tax, the distributions from the passive entity will not be subject to the margin tax.

Other Exempt Entities

In addition to passive entities, certain other entities are exempt from the margin tax. For example, general partnerships that are wholly owned by natural persons (*i.e.*, individuals) are exempt from the margin tax. Additionally, certain REITs are also exempt from the margin tax.

Production Costs

An entity that is subject to the margin tax may be able to deduct a substantial amount of its production costs and expenses. As discussed above, a taxable entity may elect to deduct its cost of goods sold, which includes the cost of mining and extracting minerals as well as the related labor costs. Additionally, the following is a list of a few of the items that will prove valuable to the oil and gas industry in calculating cost of goods sold:

- ➢ labor costs (other than officer compensation)
- ➢ depletion, depreciation, and amortization
- ➢ storage, handling, and inbound (but not outbound) transportation costs
- ➢ rental and leasing costs related to the production activity
- ➢ geological and geophysical costs incurred to locate producing properties
- ➢ abandonment costs
- ➢ property taxes and sales taxes associated with producing and extracting the minerals

Certain costs are specifically excluded from the calculation, such as distribution costs, interest on debt incurred to finance the production and extraction of minerals, and bidding costs. Although an entity must calculate the components of the deduction "in accordance with the methods used on its federal income tax return," keep in mind that the overall calculation of cost of goods sold is different for federal and state tax purposes. Additionally, special rules apply for production costs paid between related entities.

Compensation

Except in certain limited cases, if an entity's compensation expenses exceed its cost of goods sold, it will take a deduction for compensation. The compensation deduction includes wages and other compensation (including stock and stock options deducted for federal income tax purposes) paid to employees, officers, and owners. Additionally, certain employee benefits and net distributive income distributed to owners are also included as deductible compensation. However, an entity may not deduct more than $300,000 per 12 month period for any one officer, director, employee or owner. In the case of a combined group (as described below), the entire group may not deduct more than $300,000 per 12 month period for each person.

The compensation deduction specifically excludes contract wages reported on IRS Form 1099, payroll taxes, and payments to undocumented workers.

Combined Reporting

Another major change under the margin tax is the introduction of combined group reporting. Entities that are part of a combined group (*i.e.*, one or more entities engaged in a "unitary business" in which a controlling interest is owned by a common owner or one or more of the member entities) must file a single report on behalf of the group. The determination of whether entities are engaged in a unitary business is a facts and circumstances analysis, although the Comptroller's rules provide that the presence of strong centralized management creates a presumption of a unitary business.

As a result of the combined reporting requirement, there is now less incentive to structure (for tax purposes) a business using several related taxable entities. Operators and non-operators could be required to file a single report if they are commonly owned. Moreover, because each member of the group is required to make the same election to deduct cost of goods sold or compensation, operators and non-operators filing a single report may receive less favorable treatment than they would otherwise receive if they filed separate reports.

Additionally, the combined group reporting now requires that companies be concerned about the disclosure obligations of combined groups. A company that is the controlling partner (i.e., owns greater than a 50% interest) in a venture with third party partners must carefully draft the joint venture agreement to ensure that the third party partners do not have access to the company's entire combined group's return. Important confidential or strategic information may be contained in the combined group return about other group members' business activities. Moreover, because each member of the combined group is jointly and severally liable for the entire combined group's tax liability, the joint venture agreement should also include an indemnification to and from the third party partners to the joint venture for any tax liability incurred by the combined group with respect to the partners' interests in the joint venture.

Tax Discounts and Tax Rate Reductions

Tax discounts of 20%-100% may be available for entities with reduced revenue, after taking the applicable deductions. For example, entities with annualized total revenue (as calculated above) of $300,000 or less are exempt from tax. The discount is completely phased out for entities with annualized total revenue of $900,000 or more, and such entities are subject to the full tax.

ENDNOTES

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A "LAST CHANCE" OPPORTUNITY FOR TAX RELIEF THAT IS OFTEN OVERLOOKED BY PROPERTY OWNERS

By: Amy Reilly Sallusti, Shareholder Attorney
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The time of year has come for all property owners to receive their favorite pieces of mailthe dreaded 2008 tax bills. Regardless of whether the property is classified as commercial, industrial, agricultural, residential, or personal property, the owner's initial reaction is always the same "how am I going to pay this tax bill?" The answer to this question is difficult for many property owners to face, especially in a down economy. However, not all hope is lost. The purpose of this article is to inform you of an opportunity for tax relief that is often overlooked by owners of property, especially owners who acquired their property after June 1st of a given year. Throughout this article I will refer to this opportunity as the "last chance" for tax relief.

Traditionally, if a property owner receives a notice of appraised value for his property and is unsatisfied with that value, the owner will file a protest under Chapter 41 of the Property Tax Code with the Appraisal Review Board. The deadline to file a Chapter 41 protest is generally May 31st. For various reasons, such as a pending sale of the property, the Chapter 41 protest deadline may be missed. In such a case, the Appraisal Review Board will certify the property's value as determined by the Appraisal District. This certified value is then used in the calculation of taxes.

Despite such certification, the owner still has one "last chance" to obtain a value correction. The owner may file a motion to correct certain types of errors in the appraisal roll under Section 25.25(d) of the Texas Property Tax Code. Section 25.25(d) can be a very useful provision for owners who have recently purchased property or anticipate purchasing property prior to the tax delinquency date, which is January 31st of the year following the assessment year. Of course, Section 25.25(d) may also provide tax relief for owners who missed their Chapter 41 protest opportunity.

In essence, Section 25.25(d) extends the time to file a challenge to the appraised value of property for properties that have been significantly overvalued due to an error. However, this "last chance" provision is subject to certain limitations. First, to be entitled to a correction under Section 25.25(d), the property owner must show the error resulted in a valuation that exceeds the correct appraised value by more than one-third. Second, the motion must be filed before the time the taxes on the property become delinquent. In general, that date is January 31st of the year following the tax year for which the taxes are owed. Third, the error in the appraised value can only be corrected if the property was not previously protested in the same tax year under Chapter 41 of the Property Tax Code. Fourth, the error can only be corrected if the appraised value of the property was not established by a written agreement between the property owner, or his agent, and the appraisal district.

The initial question that must be answered is whether the appraised value of the property is at least one-third in excess of the correct appraised value of the property. This is commonly referred to as the one-third test and seems to cause the most confusion among property owners and appraisal districts. Here is an example of how to apply the one-third test: if the appraised value of the property as reflected on the tax roll is $250,000.00, yet the property owner has evidence indicating the correct appraised value should be $180,000.00 (e.g. the property sold in August of 2008 for $180,000.00), then the property owner meets the one-third test and has his "last chance" since the error in the appraised value of the property of $250,000.00 exceeds the correct appraised value of the property of $180,000.00 by more than one-third.[2]

If the value of the property meets the one-third test, the property owner still must file a 25.25(d) motion to correct the appraised value with the Appraisal Review Board before the date the yearly taxes on the property become delinquent. Generally, the extension under 25.25(d) ends on January 31st of the year following the tax year in issue, which is the date the yearly property taxes become delinquent. This provision has been strictly and narrowly construed. Courts have gone so far as to hold that an owner of agricultural land who was assessed a rollback tax in 1997 and filed a 25.25(d) motion on January 29, 1998 could not use a 25.25(d) motion to seek relief from the past appraised market value of the agricultural land in tax years 1992-1997 since the 25.25(d) motion was not filed before the date the yearly property taxes became delinquent.[3] Since the 2008 appraisal rolls have been certified, the property owner can exercise his "last chance" and file a 25.25(d) motion at anytime between now and January 31st, 2009.

The last two hurdles the property owner must overcome in order to proceed with a 25.25(d) motion are to determine whether the property was the subject of a Chapter 41 protest and whether the property's appraised value as reflected on the appraisal roll is the result of a written settlement agreement between the property owner, or his agent, and the Appraisal District. These two issues commonly arise when the property is sold after June 1st,and it is unclear who if anyone will protest the appraised value of the property. The purpose of 25.25(d) is to permit a property owner to file a late appraisal protest and have at least one bite at the apple, but not two.

The mere filing of a Chapter 41 protest with no further action does not prevent a property owner from seeking relief under Section 25.25(d). The Courts have held that an unadjudicated protest filed by a prior property owner under Chapter 41, which is later withdrawn, does not bar a hearing on a subsequent Section 25.25(d) motion by the new property owner.[4] Furthermore, even if a Chapter 41 protest is withdrawn by the prior property owner or subsequently dismissed by the Appraisal Review Board for failure to appear, the new property owner should not be barred from seeking "last chance" relief under Section 25.25(d). However, if the prior property owner withdraws the Chapter 41 protest and enters into a written settlement agreement with the Appraisal District establishing the appraised value of the property, the new property owner is bound by the appraised value set forth in the settlement agreement and is barred from seeking additional reliefunder Section 25.25(d).[5]

Section 25.25(d) is the property owner's "last chance" for tax relief, but the property owner will be penalized for having waited to correct the appraised value of his property. As the old saying goes "there's no such thing as a free lunch." In order to exercise his "last chance," the property owner will have to pay a 10% late-correction penalty to each affected taxing unit if the appraised value of the property is corrected. However, even with the 10% late-correction penalty, the property owner can still receive significant tax relief by filing a Section 25.25(d) motion.

Furthermore, this "last chance" opportunity does not eliminate the property owner's obligation to pay the taxes due and owing on the property under Section 42.08. The property owner will forfeit his right to proceed to a final determination of the Section 25.25(d) motion if he fails to comply with Section 42.08. Generally, Section 42.08 provides that on or before January 31st of the year following the assessment year, the property owner shall pay the amount of taxes due on the appraised value of the property (the amount reflected on the tax bill) or the amount of taxes due on the portion of the taxable value of the property that is not in dispute. Even if a 25.25(d) motion is pending at the January 31st deadline, the owner still must make a timely tax payment, If a correction is made to the appraised value of the property under Section 25.25, the property owner will receive a tax refund from the affected taxing units.

In conclusion, Section 25.25(d) is truly a property owner's "last chance" for tax relief in any given tax year. If the property qualifies for "last chance" relief under 25.25(d), then the property owner should consider filing a 25.25(d) motion to correct the appraised value of the property with the Appraisal Review Board prior to January 31, 2009.

ENDNOTES

1 Geary, Porter & Donovan, P.C. is a full service law firm with a practice group devoted entirely to ad valorem taxation issues. Geary, Porter & Donovan, P.C. is located at One Bent Tree Tower, 16475 Dallas Parkway, Suite 400, Addison, Texas 75001-6837, (972) 931-9901, (972) 931-9208 (facsimile), www.gpd.com. Special thanks to Ronald D. Gray, a shareholder of Geary, Porter & Donovan, P.C., for assistance with this article.

2 To determine whether the error exceeds the correct appraised value by more than one-third take the original appraised value of$250,000 and multiply it by .75 which will provide you with the threshold value. The corrected value must be the threshold value or less.

3 *Patsy Ann Anderton v. Rockwall Central Appraisal District, et al.*, 26 S.W.3d 539, 544 (Tex.App. - Dallas 2000).

4 *Jim Sowell Construction Co., Inc. v. Dallas Central Appraisal District, et al.*, 900 S.W.2d 82, 86 (Tex. App. Dallas 1995).

5 *Dallas Central Appraisal District, et al. v. Park Stemmons, Ltd., et al.*, 948 S.W.2d 11, 14 (Tex. App. - Dallas 1997).

CHARITABLE RAFFLES IN TEXAS

Kallie S. Myers[1]

Charitable raffles are extensively regulated, and tax-exempt organizations conducting charitable raffles must comply with applicable state and federal laws. The Texas Charitable Raffle Enabling Act (the "CREA") establishes various requirements for conducting charitable raffles in Texas. In addition, the Internal Revenue Code (the "IRC") imposes requirements at the federal level.

I. The Texas Charitable Raffle Enabling Act.

A. Requirements for Charitable Raffle.

In 1989, Texas voters approved a constitutional amendment authorizing the conduct of charitable raffles by "qualified organizations."[2] The Texas Legislature enacted the CREA effective January 1, 1990 to provide the terms and conditions for such raffles.[3] The purchase of a chance to win in a raffle which does not comply with the CREA is considered a "bet" in violation of the state gambling laws set forth in Section 47.01 et. seq. of the Texas Penal Code.[4] The conduct of such a raffle may result in criminal prosecution of the conducting organization and its members, directors, officers, employees, and other agents.

The CREA places several very specific restrictions on the conduct, promotion, and administration of a charitable raffle:

1. The organization conducting the raffle must be a qualified organization.[5]

2. The raffle must involve "the awarding of one or more prizes by chance at a single occasion among a single pool or group of persons who have paid or promised a thing of value for a ticket that represents a chance to win a prize."[6]

3. A qualified organization may conduct no more than two raffles per calendar year, and if more than one raffle is conducted, the time periods during which the tickets are sold to raffles may not overlap.[7]

4. The organization may not, directly or indirectly, promote the raffle through the use of paid advertising in the mass media.[8]

5. The raffle may not be promoted or advertised statewide, and tickets for the raffle may not be sold or offered for sale statewide.[9]

6. Money may not be offered or awarded at the raffle.[10]

7. If the organization pays for or provides any consideration for the prize to be awarded, the fair market value of the prize may not exceed $50,000 unless the prize to be awarded is a residential dwelling, in which case the fair market value of the prize may not exceed $250,000.[11] A raffle may consist of one or more tickets in the state lottery with a face value of $50,000 or less, without regard to whether a prize in the lottery game to which the ticket or tickets relate exceeds $50,000.[12]

8. The organization may not compensate any person, directly or indirectly, for organizing or conducting the raffle or for selling raffle tickets.[13]

9. Persons who are not authorized by the organization may not sell or offer to sell raffle tickets.[14]

10. The following information must be printed on each raffle ticket sold or offered for sale: the name of the organization, the address of the organization or of a named officer of the organization, the price of the ticket, a general description of each raffle prize having a value of more than $10, and the date on which the prize or prizes will be awarded.[15]

11. The organization must either have in its ownership or possession the prize to be offered in the raffle or post bond with the county clerk in an amount equal to the fair market value of the prize.[16]

12. All proceeds from the sale of tickets for the raffle must be spent for the charitable purposes of the organization.[17]

13. A qualified organization may conduct a reverse raffle, which is subject to certain exceptions to the above-listed requirements.[18]

B. Explanation of Key Provisions.

1. Qualified Organization.

A "qualified organization" is (i) a qualified religious society, (ii) a qualified volunteer fire department, (iii) a qualified volunteer emergency medical service, or (iv) a qualified nonprofit organization."[19]

a. Qualified Religious Society.

A "qualified religious society" is a "church, synagogue, or other organization or association organized primarily for religious purposes" that has been in existence in Texas for at least ten years and does not distribute any of its income to its members, officers, or governing body, other than as reasonable compensation for services or for reimbursement of expenses.[20]

b. Qualified Volunteer Emergency Medical Service.

A "qualified volunteer emergency medical service" is an association that is organized primarily to provide and actively provides emergency medical, rescue, or ambulance services; does not pay its members compensation other than nominal compensation; and does not distribute any of its income to its members, officers, or governing body, other than for reimbursement of expenses.[21]

c. Qualified Volunteer Fire Department.

A "qualified volunteer fire department" is an association that operates fire-fighting equipment; is organized primarily to provide and actively provides fire-fighting services; does not pay its members compensation other than nominal compensation; and does not distribute any of its income to its members, officers, or governing body, other than for reimbursement of expenses.[22]

d. Qualified Nonprofit Organizations.

There are four types of qualified nonprofit organizations: (a) certain organizations incorporated or holding a certificate of authority under the Texas Non-Profit Corporation Act, (b) certain local chapters, affiliates, units, or subsidiary organizations of a parent organization incorporated or holding a certificate of authority under the Texas Non-Profit Corporation Act, (c) certain local chapters, affiliates, units, or subsidiary organizations of a grand lodge or other institution or order incorporated under Article 1399 of Title 32 of the Texas Revised Civil Statutes, and (d) certain unincorporated organizations, associations, or societies.[23]

i. Qualifications of Qualified Nonprofit Organizations.

In order to qualify as a qualified nonprofit organization, the organization must: (1) not distribute any of its income to its members, officers, or governing body, other than as reasonable compensation for services; (2) have existed for at least the three preceding years; (3) not devote a substantial part of its activities to attempting to influence legislation or participate in any political campaign; and (4) be exempt from federal income tax under Section 501(c) of the IRC.[24]

The third requirement is further defined by the CREA: "An organization, association, or society is considered to devote a substantial part of its activities to attempting to influence legislation for purposes of this section if, in any 12-month period in the preceding three years, more than 10 percent of the organization's expenditures were made to influence legislation."[25]

Under the fourth requirement, a charitable organization must have obtained an exemption under Section 501(c) of the IRC. Even organizations otherwise exempt from filing an IRS Form 1023, *Application for Recognition of Exemption*, must file the form to obtain an exemption and be able to operate a charitable raffle as a qualified nonprofit organization. However, many of the organizations exempt from filing a Form 1023 are organizations which would likely be considered qualified religious societies and would therefore not be required to fulfill the requirements applicable to nonprofit organizations. See I.R.C. § 508(c)(1)(A) (2002) (exempting from the filing requirement churches, their integrated auxiliaries, and conventions or associations of churches).

ii. Nonprofit Corporations.

A Texas nonprofit corporation or a foreign corporation holding a certificate of authority to conduct affairs in Texas is a qualified organization if it meets the above requirements and an additional fifth requirement that it “does not have or recognize any local chapter, affiliate, unit, or subsidiary organization in Texas.”[26]

iii. Unincorporated Organizations, Associations, or Societies.

An unincorporated organization, association, or society is a qualified nonprofit organization if it satisfies requirements (1), (3), and (4) and satisfies a modified requirement (2): “for the three preceding years has been affiliated with a state or national organization organized to perform the same purposes as the unincorporated organization, association or society.”[27]

iv. Local Chapters, Affiliates, Units, or Subsidiaries.

An organization that is formally recognized as and that operates as a local chapter, affiliate, unit, or subsidiary organization of a parent Texas nonprofit corporation or a foreign corporation holding a certificate of authority to conduct affairs in Texas is a qualified nonprofit organization if it meets the above general requirements with certain modifications: both the local organization and the parent organization must satisfy requirement (1); requirement (2) is modified to require that “the local organization has existed for the three preceding years and during those years has been formally recognized as a local chapter, affiliate, unit, or subsidiary organization of the parent organization”; both the local organization and the parent organization must satisfy requirement (3); and requirement (4) allows either the local organization or the qualified organization be exempt from federal income tax under Section 501(c).[28]

v. Local Lodge Chapters.

The CREA was amended in 2005 to allow charitable raffles to be conducted by certain formally recognized organizations that operate as local chapters, affiliates, units, or subordinate lodges of grand lodges or other institutions or orders incorporated under Article 1399 of Title 32 of the Texas Revised Civil Statutes. Such an organization is a qualified nonprofit organization if it meets the requirements described above with certain modifications: both the local organization and the incorporated grand lodge must satisfy requirement (1); requirement (2) is modified to require that the local organization has existed for the three preceding years and during those years has had a governing body or officers elected by a vote of its members or by a vote of delegates elected by its members, or has been formally recognized as a local chapter, affiliate, unit, or subordinate lodge of the grand lodge; both the local organization and the incorporated grand lodge must satisfy requirement (3); and under requirement (4), either the local organization or the incorporated grand lodge must be exempt from federal income tax under Section 501(c), or “other applicable provision.”[29]

vi. Texas Business Organizations Code.

Nonprofit organizations formed after January 1, 2006 are governed by the Texas Business Organizations Code (TBOC).[30] While certain organizations formed prior to January 1, 2006 are currently subject to the Texas Non-Profit Corporation Act (TNCPA), all nonprofit organizations (regardless of when formed) will be subject to the TBOC as of January 1, 2010, at which time the TNPCA will be repealed.[31] If the CREA is interpreted strictly, organizations formed under or otherwise subject to the TBOC may not be entitled to conduct charitable raffles; therefore, the legislature seemingly must amend the CREA to allow nonprofit corporations formed under the TBOC to conduct charitable raffles.

2. Single Drawing Among a Single Pool.

The single pool requirement was addressed in a Texas Attorney General opinion stating that selling additional tickets after the beginning of a raffle drawing would violate the statute.[32] The ticket holders who purchased tickets before beginning of the drawing would constitute one pool, and the persons among whom prizes would be awarded would constitute an impermissible second pool.[33]

3. Time and Frequency Restrictions.

The limit of two raffles per year is calculated based on a calendar year beginning January 1 and ending on the succeeding December 31.[34] Before selling or offering to sell tickets, the organization must set a date on which the raffle will be held and the prize or prizes will be awarded.[35] The organization must award the prize or prizes on that date unless it becomes unable to do so; if unable to award the prize or prizes on that date, the organization may set another date not later than thirty days from the original date.[36] If the prize or prizes are not awarded within this thirty day period, the organization must refund or offer to refund the amount paid by each person who purchased a ticket for the raffle.[37]

4. No Money Prizes.

The CREA defines “money” as “coins, paper currency, or a negotiable instrument that represents and is readily convertible to coins or paper currency.”[38] A Texas Attorney General Opinion states that neither savings bonds nor prepaid credit cards are negotiable instruments and that they are therefore allowed as prizes in a charitable raffle.[39]

5. Ownership or Possession of Prizes.

The CREA is unclear as to whether the ownership or possession requirement must be met throughout the raffle period or only on the day of the raffle. An assistant Dallas County district attorney stated that the purpose of this provision is to ensure that the organization can actually deliver the prize to the raffle winner, which indicates that the ownership or possession requirement must be met throughout the raffle period.

6. All Proceeds Spent for Charitable Purposes.

A Texas Attorney General Opinion ruled that an organization “may use a portion of the gross raffle proceeds to pay the reasonable, incidental, and necessary expenses of conducting the raffle from which the proceeds were raised, but ordinarily no raffle proceeds may be used to fund subsequent raffles.”[40] The opinion further stated that “all proceeds” should be interpreted to mean that the net proceeds of the raffle must be spent for the charitable purposes of the organization.[41] The net proceeds are the “proceeds after payment of reasonable, incidental, and necessary expenses.”[42]

"Charitable purposes" include benefiting needy or deserving persons in Texas by: enhancing their opportunities for religious or educational advancement; relieving them from disease, suffering, or distress; contributing to their physical well-being; assisting them in establishing themselves in life as worthy and useful citizens; or increasing their comprehension of and devotion to the principles on which this nation was founded and enhancing their loyalty to their government. "Charitable purposes" also include initiating, performing, or fostering worthy public works in Texas, or enabling or furthering the erection or maintenance of public structures in Texas. Tex. Occ. Code Ann. § 2002.002(1).

A Texas Attorney General Opinion states that whether funds are used for a charitable purpose under the CREA is a question of fact.[43] The opinion also provides that the CREA requires raffle proceeds to be used for the direct charitable purposes of the organization and that fundraising itself may not be a charitable purpose.[44] Nonetheless, the opinion did not conclude that fundraising may never be a charitable purpose, as there "may be certain organizations who do nothing but raise funds for other charitable organizations."[45]

7. Reverse Raffles.

A "reverse raffle" is a raffle in which the last ticket or tickets drawn are considered the wining tickets.[46] Reverse raffles are provided certain exceptions to the charitable raffle requirements. For instance, a refund of the purchase price of a ticket may be awarded as a prize in a reverse raffle notwithstanding the requirement for ordinary raffles that the prize not be money.[47] The organization conducting the reverse raffle may auction off additional tickets to persons who are present at the drawing for a price other than the price printed on the ticket.[48]

After the drawing of tickets in a reverse raffle has begun, the organization may permit a ticket holder present at the drawing to resell the ticket to another person present at the drawing for an amount greater than the original purchase price of the ticket if the sale is made through a designated representative of the organization and not less than 10 percent of the sale proceeds are retained by the organization.[49] Only the portion of the proceeds from the resale of the ticket retained by the organization must be spent for the charitable purposes of the organization.[50] After the ticket drawing has begun, the organization may also permit the holder of a previously drawn ticket to purchase additional chances for the ticket to be selected to win a prize or to purchase additional tickets for the raffle.[51] For purposes of the provision requiring proceeds be spent for charitable purposes, all proceeds from the sale of additional chances for a ticket are to be considered proceeds from the sale of the ticket.[52]

II. Federal Limitations.

A. The Organized Crime Control Act.

The Organized Crime Control Act makes conducting, financing, managing, supervising, directing, or owning an illegal gambling business a federal crime.[53] "Gambling" includes conducting lotteries or selling chances therein.[54] To be considered an "illegal gambling business," the activity must be in violation of the law of the state or political subdivision in which it is conducted.[55] The statute does not apply, however, to any lottery or similar game of chance conducted by an organization exempt from tax under IRC Section 501(c)(3) if no part of the gross receipts derived from such activity inures to the benefits of any private shareholder, member, or employee of such organization except as compensation for actual expenses incurred by him in the conduct of such activity.[56]

B. Section 501(c) Exemption.

The CREA requires a qualified nonprofit organization to have obtained recognition of tax exempt status as an IRC Section 501(c) organization. It is therefore necessary to determine what requirements an organization must meet to qualify as a Section 501(c) organization. Section 501(c) organizations are subject to unrelated business income tax ("UBIT") on revenues derived from the conduct of a regularly carried on trade or business which is not substantially related to exempt purposes.[57] Because the CREA limits the number of charitable raffles conducted per calendar year to two, qualified charitable raffles in Texas should not be considered regularly conducted gaming. Moreover, an exclusion to the UBIT may apply, such as the volunteer labor exception or the exclusion for qualified public entertainment activities.[58]

Section 501(c)(3) organizations include those operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, to foster national or international amateur sports competition, or prevention of cruelty to children or animals.[59] As Section 501(c)(3) organizations must be organized and operated for these enumerated purposes, the sole purpose of a Section 501(c)(3) organization cannot be to conduct charitable gaming.

Section 501(c)(3) organizations are classified as either public charities or private foundations. I.R.S., Pub. 3079 (4-98), Gaming Publication for Tax-Exempt Organizations 5–6 (1998) [hereinafter Gaming]. Charitable organizations conducting gaming are generally those classified as public charities under Sections 509(a)(1) and 170(b)(1)(A)(vi) or Section 509(a)(2).[60] Section 509(a)(1) and 170(b)(1)(A)(vi) organizations typically receive a substantial portion of support from a governmental unit or from direct or indirect contributions from the public.[61] Section 509(a)(2) organizations typically receive "more than one-third of support from any combination of gifts, grants, contributions, membership fees, and gross receipts from permitted sources, and not more than one-third of support from gross investment income and the excess of the net unrelated business taxable income after taxes as imposed by Section 511."[62] Gross receipts from gaming activities that are not from an unrelated trade or business are counted as "public support," subject to applicable percentage limitations.[63] In contrast, gaming that is an unrelated trade or business may adversely affect the ability of those organizations to meet the applicable public support test. This could cause these organizations to be determined to be private foundations.[64]

Section 501(c)(4) organizations include civic leagues, social welfare organizations, and local associations of employees.[65] Section 501(c)(4) organizations are also subject to the inurement proscription.[66] Section 501(c)(4) organizations may not conduct gaming as a primary activity because gaming is considered a business and recreational activity and does not ordinarily promote social welfare.[67] An organization operating a social facility such as a bar, restaurant, or game room as its primary activity is not exempt.[68] Nonetheless, such activity may be appropriate for this type of organization when the activity furthers the organization's exempt purpose. For example, social activities engaged in to increase camaraderie of firemen promote social welfare because they encourage better performance.[69]

Section 501(c)(5) organizations include labor, agricultural, and horticultural organizations, and Section 501(c)(6) organizations include business leagues and similar organizations.[70] Gaming activities do not serve exempt purposes of either Section 501(c)(5) or 501(c)(6) organizations, so gaming activities could jeopardize these organizations' exemptions or cause them to become subject to the UBIT.

Section 501(c)(7) organizations include social and recreational clubs; Section 501(c)(8) organizations include fraternal beneficiary societies, orders, or associations; Section 501(c)(10) organizations include domestic fraternal societies, orders, or associations; and Section 501(c)(19) organizations include veterans' organizations and their auxiliary units.[71] These organizations include within their exempt functions providing social or recreational activities for members and their bona fide guests.[72] Gaming involving only members directly furthers their social or recreational purposes; however, gaming activities open to the general public may result in UBIT or adversely affect the organizations' exempt status.[73]

III. Other Tax Issues.

A. Federal Income Tax Issues.

1. Non-Deductibility of Raffle Tickets.

A purchaser of a raffle ticket may not deduct any portion of the purchase price as a charitable contribution because the purchaser is viewed as acquiring something of value—the opportunity to win a prize.[74] The entire price of the raffle ticket is deemed a payment for goods or services.[75]

2. Recordkeeping.

Exempt organizations must maintain all books and records used to determine tax liabilities and to determine information reporting responsibilities. Organizations should keep the "same types of books and records that would be maintained by any other business, including cash receipts and disbursement journals, accounts payable journals, general ledgers, detailed source documents, and copies of any federal tax returns filed."[76]

3. Withholding.

Raffle prizes are included in the winner's gross income for federal tax purposes.[77] Any payor of "gambling winnings" that are subject to withholding must deduct and withhold from such payment a tax in an amount equal to a certain percentage of such payment.[78] Gambling winnings that are subject to withholding include proceeds of more than $5,000 from a wager placed in a sweepstakes, wagering pool or lottery other than a state-conducted lottery.[79] "Proceeds from a wager" equal the amount paid to the winner less the amount of the wager, and include proceeds which are not money.[80] Raffles and similar contests conducted by exempt organizations are considered lotteries for purposes of these provisions. If a prize recipient fails to provide a taxpayer identification number, a higher backup withholding rate instead applies.[81] A higher withholding rate also applies to prizes won by nonresident aliens, and there is no dollar threshold that must be reached before withholding applies.[82] For purposes of determining the amount of withholding or backup withholding, the fair market value of the item won is considered the amount of the winnings.[83]

An exempt organization is responsible for paying withholding or backup withholding regardless of whether the organization collects the withholding amount from the prize recipient.[84] If amounts are not properly withheld or deposited in the United States Treasury and cannot be immediately collected from the organization, a penalty may apply. A person who willfully fails to pay over such tax is guilty of a felony and could be subject to a fine or imprisonment, or both.[85] Since an exempt organization is required to withhold federal income tax, it is recommended that the raffle tickets state that the winner must pay these taxes in order to receive the prize.

4. Form 990 Annual Returns.

In 2007, the Internal Revenue Service issued a draft of a redesigned Form 990, *Return of Organization Exempt from Income Tax*, designed to enhance transparency and promote tax compliance. The IRS will use this redesigned Form 990 beginning in the 2008 tax year. Due to concerns about the lack of transparency concerning fundraising activities, particularly regarding how much of each dollar given by a donor in good faith is actually provided to a charity for charitable work, the redesigned draft of the Form 990 requests additional information on fundraising and gaming activities on Schedule G for all exempt organizations with gross income of more than $10,000 from fundraising events and all exempt organizations that pay more than $10,000 to professional fundraisers. Schedule G requires disclosure of the gross revenue received by the organization from its gaming activities, the expenses incurred by the organization for cash and non-cash prizes awarded in connection with such gaming activities, whether the organization complied with the federal income tax withholding rules, how many Forms W-2G were filed for gaming activities, and other information regarding licensing, the use of promoters, and state law requirements for distribution of gaming proceeds.

D. Texas State Taxes.

1. Sales Tax.

An organization is not required to collect sales tax on the purchase of raffle tickets by participants.[86] However, there may be sales tax on the purchase of a raffle item by the qualified organization. The Texas Tax Code provides exemptions from sales tax on certain organizations' purchases. An organization created for religious, educational, or charitable purposes will be exempt if no part of the net earnings of the organization benefits a private shareholder or individual and the items purchased, leased, or rented are related to the purpose of the organization.[87] An organization qualifying for an exemption from federal income taxes under Section 501(c)(3), (4), (8), (10), or (19) will be exempt from paying sales tax if the item sold, leased, rented, stored, used, or consumed relates to the purpose of the exempt organization and the item is not used for the personal benefit of a private stockholder or individual.[88] The Texas Tax Code provides certain additional exemptions.

The requirement that the purchased item be related to the charitable purpose of the organization is problematic because conducting raffles is not considered a charitable activity for federal tax purposes. The Texas Comptroller has stated that "[i]tems purchased to be used as prizes in a raffle are generally subject to tax at the time of purchase."[89]

2. Motor Vehicle Prizes.

The transfer of title to a new motor vehicle as a prize to the winner of a raffle is taxed differently depending on the type of transfer. If the motor vehicle title is transferred directly from the dealer to the winner, motor vehicle sale or use tax is due from the sponsor of the contest to the dealer on the total consideration paid for the vehicle. If no consideration was paid, this tax is not applicable, but a $10 gift tax is instead due.[90] If a dealer transfers title to a motor vehicle to a contest sponsor, and the sponsor subsequently transfers title to the vehicle to the winner, the sponsor owes motor vehicle sales or use tax on the total consideration paid for the vehicle to the dealer and the winner owes a $10 gift tax.[91] If no consideration was paid for the vehicle, the sponsor and the winner each owe a $10 gift tax.[92] Because the CREA requires the organization to have the prize in its possession or ownership or post bond, it may be difficult for the organization to hold a raffle in which the motor vehicle prize is passed directly from the dealer to the winner.

IV. Other Forms of Charitable Gaming.

Other authorized forms of gaming by charitable organizations will be addressed in an upcoming issue of The Texas Tax Lawyer.

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2 Tex. Const. art. III, § 47(d).
3 Act of June 15, 1989, ch. 957, § 1, 1989 Tex. Gen. Laws 4022.
4 Tex. Penal Code Ann. §§ 47.01–47.10 (Vernon 2003).
5 Tex. Occ. Code Ann. § 2002.051 (Vernon 2004).
6 *Id.* § 2002.002(6).
7 *Id.* § 2002.052.
8 *Id.* § 2002.054(a)(1).
9 *Id.* § 2002.054(a).
10 *Id.* § 2002.056(a).
11 *Id.* § 2002.056(b).
12 *Id.* § 2002.056(c).
13 *Id.* § 2002.054(b).
14 *Id.* § 2002.054(c).
15 *Id.* § 2002.055.
16 *Id.* § 2002.056(d).
17 *Id.* § 2002.053.
18 *Id.* § 2002.0541.
19 *Id.* § 2002.002(2).
20 *Id.* §2002.002(3).
21 *Id.* §2002.002(4).
22 *Id.* §2002.002(5).
23 Tex. Occ. Code Ann. § 2002.003.
24 *Id.*
25 *Id.* § 2002.003(d).
26 *Id.* § 2002.003(a).
27 *Id.* § 2002.003(c).
28 *Id.* § 2002.003(b).
29 *Id.* § 2002.003(b-1).
30 Tex. Bus. Orgs. Code Ann. §402.001 (Vernon 2006).
31 *Id.* §402.005.
32 Tex. Att'y Gen. Op. No. GA-0097 (2003).
33 *Id.*
34 Tex. Occ. Code Ann. § 2002.052(a).
35 *Id.* § 2002.052(d).
36 *Id.*; Id. § 2002.052(e).
37 *Id.* § 2002.052(f).
38 *Id.* § 2002.002(1-a).
39 Tex. Att'y Gen. Op. No. GA-0341 (2005).
40 Tex. Att'y Gen. Op. No. JC-0046 (1999).
41 *Id.*
42 *Id.*
43 Tex. Att'y Gen. Op. No. JC-0046 (1999).
44 *Id.*
45 *Id.*
46 Tex. Occ. Code Ann. § 2002.002(7)
47 *Id.* § 2002.0541(b).
48 *Id.* § 2002.0541(c).
49 *Id.* § 2002.0541(d).
50 *Id.* § 2002.0541(f).
51 *Id.* § 2002.0541(e).
52 *Id.* § 2002.0541(f).
53 18 U.S.C. § 1955(a) (2000).
54 *Id.* § 1955(b)(2).
55 *Id.* § 1955(b)(1)(i).
56 *Id.* § 1955(e).
57 I.R.C. §511.
58 I.R.C. §§513(a)(1), 513(d)(2).
59 *Id.* §501(c)(3).
60 *Id.*
61 *Id.*
62 *Id.*
63 *Id.*
64 *Id.*
65 I.R.C. §501(c)(4)(A).
66 *Id.* §501(c)(4)(B).
67 Gaming at 5.
68 Rev. Rul. 65-150, 1966-2 C.B. 147.
69 Rev. Rul. 74-361, 1974-2 C.B. 159.
70 I.R.C. §§501(c)(5), (6).
71 §§§§501(c)(7), (8), (10), (19).
72 Gaming at 5.
73 *Id.*
74 Rev. Rul. 67-246, 1967-2 C.B. 104.
75 *Id.*
76 *Id.*
77 I.R.C. § 74.
78 *Id.* §3402(q)(1).
79 *Id.* §3402(q)(2).
80 Treas. Reg. § 31.3402(q)-1(c)(i).
81 Gaming at 14.
82 *Id.*
83 *Id.*
84 *Id.* at 15.
85 I.R.C. § 7202.
86 Tex. Comp. 200010791L (Oct. 13, 2000).
87 Tex. Tax Code Ann. § 151.310(a) (Vernon 2008).
88 *Id.* § 151.310(b).
89 Tex. Comp. 9809136L (Sept. 22, 1998).
90 34 Tex. Admin. Code § 3.80 (1979) (Tax Admin., Motor Vehicles Awarded as Prizes).
91 *Id.*
92 *Id.*

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