CECB Carnahan, Evans, Cantwell & Brown, P.C.

on the Subject

June 2011

Richard T. Ashe Named Shareholder

Carnahan, Evans, Cantwell & Brown is pleased to announce that Richard "Ric" Ashe has become a shareholder of the firm.

Ric concentrates his practice on a wide variety of business litigation and dispute resolution, including matters concerning non-competition agreements and trade secrets, shareholder disputes, real estate agreements and construction law, as well as general business matters and litigation arising in the context of other areas of firm expertise, including Trust, Estate, Banking, and Tax matters. Ric has broad experience dealing with contract disputes of all types.

Ric joined CECB in 2007, after practicing for five years at the respected Portland, Oregon, law firm of Dunn Carney Allen Higgins & Tongue, LLP. Ric attend law school at Northwestern School of Law of Lewis and Clark College in Portland, where he graduated cum laude while also working full time and helping to raise two daughters with his wife Laura. As a student, he received the prestigious Law Review Excellence Award and served as a research assistant for Professor Janet Steverson.

A Missouri native, Ric received his undergraduate degree at Missouri State University. During undergraduate school, he owned and operated a painting company and extensively explored the Ozarks by canoe, foot and bike. After graduation, he owned and operated a fencing company before moving his young family away from Springfield so he could attend law school.

Since returning to Missouri, Ric has twice been named to the "Rising Star" list by the Missouri/Kansas Super Lawyers publication (2009 and 2010). He has worked in courthouses throughout southwest Missouri, from Cassville to Hartville and from Forsythe to Bolivar, as well as the U.S. District Court and Missouri Court of Appeals in Springfield.

When not practicing law, you can expect to find Ric working in the yard with his wife or floating one of the many beautiful Ozarks rivers and streams with his daughters.

Tax Court Affirms Treatment of State Tax Credits As Short-Term Capital Gains

by Frank C. Carnahan

The Tax Court found that transferable Colorado state conservation easement income tax credits sold by individuals were capital assets because they were not noncapital assets under Code Sec. 1221 and were not a substitute for ordinary income, because the credits did not represent a right to income. Section 1221(a) defines "capital asset" as "property held by the taxpayer" other than eight specifically excluded categories. None of the eight excluded categories describes State tax credits such as those received and sold by the taxpayers. The holding period for the credits began when the taxpayers received the credits, not when they acquired the real property that was subject to the conservation easement, and consequently it was short term capital gain. The decision follows a similar Tax Court holding in *Tempel v. Commissioner*, CCH Dec. 58,594, 136 T.C. ___ (2011). ■

Meet our New Attorney: Taylor C. Moore

Carnahan, Evans, Cantwell & Brown is excited to announce Taylor C. Moore joined the firm in May. Taylor joins the firm as an associate in the Litigation/ Dispute Resolution and Banking Practice Groups and concentrates his practice in the areas of Banking, General Corporate, Commercial Litigation, and Real Estate.

Taylor has extensive experience handling all aspects of creditor rights and banking litigation and over the years has served as counsel for regional and national banks, and Fortune 500 companies. He has also served as lead trial and appellate counsel in a wide range of business disputes for many regional businesses.

Taylor received his Bachelor of Arts from Louisiana State University and his law degree from the Paul M. Hebert Law Center at Louisiana State University. While attending law school, Taylor earned a membership on the Moot Court Board and served as Chairman of the Moot Court Tullis Competition. He was also honored with the Gene Hearn Memorial Scholarship for outstanding academic performance and received three CALI Awards for being the number one student in Civil Law Property, UCC Commercial Paper/Negotiable Instruments, and Labor Law. In addition, Taylor was published in the Journal of Maritime Law and Commerce and was selected to serve as research assistant for Professor Wendell Holmes, who authored the definitive treatise on Louisiana business organizations.

in this issue

What Do All of Those Abbreviations Mean?

by John M. Carnahan, III

In the legal profession, especially estate and tax planning, we are guilty of using acronyms or abbreviations to describe certain types of entities, and many times the tax characteristics thereof.

Some of the more common uses in the firm's practice involve using initials to describe either the legal entity, or fairly technical tax aspects or elections. This first article will deal with entities, and in our next newsletter, we will deal with some of the more commonly used tax descriptive acronyms, such as QSST, QDRO, ESBT and QTIP.

In the entity world, we are normally looking at three characteristics in trying to assist the client in choosing the best format for their future business activities. The characteristics are:

1. Protection against liability;
2. Tax aspects – is it a pass through, or does the entity pay the taxes? and
3. Management structure.

Corporations

Forty years ago, your choices were fairly limited, and basically you could choose a corporation, which provided protection against liability, and then you had to choose if you wanted a regular subchapter "C" corporation (describing the subpart of the Internal Revenue Code in which corporate taxation is found, starting at §301) or a subchapter "S" (describing the subpart of the Internal Revenue Code in which corporate taxation is found, starting at §1361). Both "C" corporations and "S" corporations protect the shareholders from liability. "C" corporations pay a tax at their level, and "S" corporations pass their income or losses, under fairly complicated rules, to their shareholders (who then pay the tax or receive the tax benefit). Other types of corporations permitted (sometimes with different tax characteristics) include "not-for-profits," which are generally governed by totally different provisions of the Internal Revenue Code, and Professional Corporations ("P.C.'s"), which were intended to allow the corporate practice of professions, subject to fairly strict rules regarding operations and ownership. P.C.'s have modified "C" corporation tax rules which, to a certain degree, limit their tax benefit, though they can provide protection against personal liability, especially in situations involving multiple member professional groups.

Partnerships

Other choices include entities under subchapter "K", which basically are partnerships. Once again, forty years ago, you had two descriptive types of partnerships. General partnerships had full pass through of tax attributes, but had the burden of joint and several liability among the partners. This would mean that if one partner did an act on behalf of the partnership, resulting in potential liability, all of the other partners were jointly and severally liable and responsible for that act, and possibly resulting damages. Your alternative for a pass through entity (once again, under more complicated rules) were limited partnerships ("L.P.s"). These had a general partner ("G.P.") and limited partners. The general partner had full management responsibilities, and the limited partners had very limited voting power, but in exchange for that, they had limited liability, whereas the general partner had full liability.

In partnerships, you usually had majority rule, and in limited partnerships you had general partner rule. In the corporate arena, you had officer rule, as approved by boards, as approved by shareholders.

Against this background, creative tax practitioners and state legislatures took it upon themselves to create other types of entities, which offered more flexibility for the owners and tried to achieve pass-through status without personal liability. The more common entities formed, and the acronyms used, are:

Limited Liability Companies (LLCs)

Like general partnerships, these are basically full pass through entities, but the members (as they are called) are not subject to personal liability for acts of the entity, but only for their personal acts. These were started in the 1980s, and Missouri adopted its Act in 1993, and these are probably the dominant form of new business entities formed in the United States today. They have benefits such as while having an Operating Agreement, they are not usually required to keep annual minutes or file franchise taxes or annual registration reports.

Limited Liability Limited Partnerships (LLLPs)

These are special limited partnerships which are known as registered limited liability limited partnerships ("LLLPs"), and are required to file annual renewal applications electing to be taxed as an LLLP. The benefit of the LLLP is that the general partner, while still having full management authority, has the same protection as the limited partners from liability. ■

Tax Court Again Invalidates Two-Year Limitations Regulations For Requesting Equitable Innocent Spouse Relief

by Frank C. Carnahan

The Tax Court in *Pullins*, 136 TC No. 20, reiterated that Congress did not impose a two-year limitations period when it enacted Code Sec. 6015(f) and the IRS should not have imposed one by regulation.

The Supreme Court in *Mayo Foundation* (2011-1 USTC ¶50,143) held that the appropriate standard of deference to review challenged regulations is the standard in *Chevron USA* (467 U.S. 837, 1984). Under Chevron, regulations are generally entitled to significant deference. The Tax Court in *Pullins* found that when it decided *Lantz*, it had used the *Chevron* standard, and concluded there was no need to reconsider *Lantz* in light of *Mayo*.

A number of *Lantz*-type Code Sec. 6015(f) cases are scheduled for argument in the circuit courts of appeal: *Coulter* (Docket No. 10-680) in the Second Circuit on June 14; *Jones* (Docket No. 10-1985) in the Fourth Circuit on May 12; other cases pending include *Buckner* (Docket No. 10-2056) and *Hall* (Docket No. 10-2628) in the Sixth Circuit, and *Payne* (Docket No. 10-72855) in the Ninth Circuit. ■

IRS Undertakes Review Of Equitable Innocent Spouse Rules After Lawmakers Voice Concerns

by Frank C. Carnahan

Three senators wrote to IRS Commissioner Douglas Shulman on April 18, 2011 expressing concern that [t]he two-year limitations period on claims for equitable innocent spouse relief prevents innocent spouses from receiving the relief they deserve," In a separate letter, 50 members of the House said that Congress did not intend to impose a two-year limitations period under Code Sec. 6015(f).

Commissioner Douglas Shulman told lawmakers in an April 29, 2011 letter that the IRS is reviewing the two-year limitations period on claims for equitable innocent spouse relief. ■

IRS Lien Superior to Bank Deed of Trust with Error in Legal Description

by Frank C. Carnahan

KleinBank, Plaintiff, v. Raymond W. Haugland, 107 AFTR 2d 2011-XXXX (D.C. MN. 12/29/2010), decided by the Minnesota U.S. District Court, highlights the importance of proper documentation and proofing of legal descriptions. The Court awarded summary judgment to the Government on finding that KleinBank's mortgage could not be summarily enforced at the time the Government filed its NFTLs in March 2009, because the mortgage legal description did not describe the entire parcel. Consequently, federal law required the Court to find that KleinBank's mortgage with respect to Track L (the omitted track) was inchoate and that the Government's liens therefore had priority.

KleinBank's mortgage, recorded January 22, 2004, omitted an entire page of the legal description, and only encumbered Tract K, which was one half of the parcel, omitting Track L. There was no dispute that KleinBank's mortgage was intended to secure the entire single contiguous parcel of lakefront property. The Warranty Deed and Contract for Deed both described the entire contiguous parcel, and the Aikin County Recorder properly indexed KleinBank's mortgage and described the entire parcel. The Government recorded two Notices of Federal Tax Liens ("NFTLs") in the office of the Aitkin County Recorder against the Hauglands on March 4 and 17, 2009.

The Court distinguished *KleinBank* from situations where questions of fact remained as to whether the error in the property description could be interpreted in only one way or whether the mortgage company could summarily enforce its rights without doing anything else, and used as an example another case where the correct description was "Northeast 1/4 of the Northeast 1/4," but the mortgage at issue said the "Northeast 1/4 of the Northeast 14."

KleinBank asserted it was entitled to have its mortgage reformed and declared senior to the Government's liens because the Government had constructive notice of KleinBank's mortgage when the tax liens were filed in March 2009. The Government asserted that its liens took priority over KleinBank's incomplete mortgage under the doctrine of choateness.

The Court held that State law determines the nature and extent of a taxpayer's interest in property, but federal law governs the relative priority accorded to the competing liens asserted against the property of the delinquent taxpayer. Federal tax liens do not automatically have priority over all other liens, and absent provision to the contrary, priority for purposes of federal law is governed by the common-law principle that "the first in time is the first in right." The Court also held that when a lien has become choate or perfected is a question of federal law.

KleinBank explained that under federal law, a mortgage is properly choate if it is specific as to: 1) the identity of the lienor; 2) the amount of the lien; and 3) the property subject to the lien. There was no dispute with respect to the first two elements. KleinBank contended that Minnesota real estate law puts the Government in the shoes of a hypothetical judgment lienholder who would have had constructive notice of KleinBank's mortgage. KleinBank based this part of its argument on the "protected under local law" portion of 26 U.S.C. §6323's definition of "security interest", and argued that the Government had constructive notice because its mortgage was correctly indexed with Aitkin County, which should have led the Government to discover the correct legal description.

The Government asserted that KleinBank's mortgage was inchoate because there was something more to be done to the mortgage's incorrect legal description before the lien could be enforced, KleinBank's lawsuit itself showed that its mortgage could not be summarily enforced, and that whether KleinBank was entitled to have its mortgage reformed is separate from the priority of the Government's tax liens because KleinBank's mortgage was not perfected when the NFTLs were filed and any reformation would not relate back to the Government's liens. ■

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The IRS Announced a New Effort to Help Struggling Taxpayers

by Frank C. Carnahan

The IRS announced a series of new steps to help struggling individual and small business taxpayers get a fresh start and meet their tax obligations:

- Significantly increasing the dollar thresholds before liens are generally filed
- Liens will now be withdrawn once full payment of taxes is made if the taxpayer requests it, and the IRS will streamline internal procedures to allow collection personnel to withdraw liens
- For taxpayers with unpaid assessments of $25,000 or less, the IRS will allow lien withdrawals under several scenarios:
    - entering into a Direct Debit Installment Agreement
    - conversion of a regular Installment Agreement to a Direct Debit Installment Agreement
    - on existing Direct Debit Installment agreements on taxpayer request
- Liens will be withdrawn after a probationary period demonstrating that direct debit payments will be honored
- Raising the dollar limit to allow more small businesses (filing either as an individual or as a business) to use streamlined Installment Agreements (a Direct Debit Installment Agreement is required):
    - $25,000 or less (Currently, $10,000) in unpaid tax can participate
    - Liabilities over $25,000 can be paid down to less than $25,000 to participate
    - Allowing 24 months to pay
- The IRS is also expanding a new streamlined Offer in Compromise (OIC) program to include taxpayers with:
    - annual incomes up to $100,000
    - tax liability of less than $50,000 (doubling the current limit of $25,000 or less)

Note: Taxpayers can use the Online Payment Agreement application on http://www.IRS.gov to set-up Direct Debit Installment Agreements.

See IR-2011-20 for more http://www.irs.gov/newsroom/article/0,,id=236540,00.html. ■

Copyright Law in Construction During the Electronic Era

by Richard B. Maltby

At a recent Construction Specifications Institute meeting, I had the occasion to discuss with its Southwest Missouri Chapter members, some of the legal aspects of conducting business through electronic media and converting to electronic recordkeeping, i.e., "going paperless." While we covered a number of topics, including the validity of electronic signatures and documents, making a contract that protects a firm in an electronic transaction, and best practices for electronic project documentation and records retention, another area requiring attention in the electronic era is architectural and engineering design copyright law.

Two basic types of design copyrights are recognized by the Copyright Act. A design professional can copyright the physical building, which includes the shape of any two or three dimensional works. The architect may also protect the actual plans and drawings that are used to construct the building. It is this latter category that has been the subject of controversy as it pertains to electronic information. Plans, drawings, and specifications are now routinely maintained electronically as CADD drawings, and 3D modeling, or building information modeling (BIM), is becoming more prevalent in the electronic age.

Copyright infringement generally occurs when a person had access to copyrighted work, which is work that is considered sufficiently original, and the allegedly infringing work is substantially similar to the copyrighted work. There are three common scenarios where copyright infringement issues arise in construction as it pertains to electronically stored information. The owners or developers who construct or operate multiple stores, chains, or facilities that are similar in design sometimes run into issues passing along designs from one project team to the next. During the recession, problems have also frequently occurred when a project is halted due to an owner's insolvency and the project is purchased by a subsequent owner who "borrows" the same or similar design concept. Further, in the homebuilder context, a common copyright situation arises when the buyer asks a developer or design professional for a particular design, but then decides not to retain that developer or design professional yet retains the design drawings and provides them to someone else to build the exact same house.

Whether you are an owner, developer, contractor, subcontractor, or design professional, a sound contract can minimize your exposure and prevent problems as they pertain to electronic copyright infringement issues. For instance, while the default rule is that the designer typically owns the copyright, the parties can spell this out in their contract so that there is no uncertainty among the parties. The standard form agreements prepared by the American Institute of Architects reflect the industry standard of designating the designer as the owner of the design. However, certain owners (such as chain restaurants or hotel owners) find it valuable to have ownership rights with respect to designs of their architects and engineers and are willing to bargain for these rights. Further, if someone other than the designer will have ownership rights, the parties must decide whether that person merely will have a license to use the design in a limited capacity or whether that person will possess exclusive ownership rights.

In addition, the parties should address how various sets of drawings should be handled during and after a project. While it is not unusual for a contractor to provide the owner with a set of as-built drawings upon final completion, the parties should address the usage rights under which the drawings are being provided since even the as-builts, particularly if existing in electronic form, can be fairly easily converted to design documents. The owner and/or the design professional may also require the contractor to maintain only one set of design drawings (or at least limited sets), which must be returned at the end of the project.

If the owner of the design intends to protect its copyright and retain control over it, then the contract can include language to make this known to all parties. It should include language that, even if publication of the design is necessary to comply with governmental regulations, such publication is not a waiver of copyright interests.

The owner of a copyright should also provide formal notification of copyright by simply indicating "copy 2011 by John Doe" or "© 2011 John Doe" on the drawings and specifications. In addition, the copyright owner should register the copyright with the U.S. Copyright Office. These precautionary steps provide additional proof of copyright, including the date and content, and establish the basis for filing a lawsuit in the event infringement occurs.

These are several of the basic concepts to help minimize risk and uncertainty concerning infringement of electronic information on construction projects. However, there are other copyright issues that can arise as it pertains to usage of electronic design documents in construction. Please contact a member of the litigation group at Carnahan, Evans, Cantwell & Brown, P.C. if you would like to further discuss these matters or have any questions. ■

Firm News

Rich Maltby, a member of the Firm's litigation group, participated in the Associated General Contractors of America Convention, which occurs annually, and the CONEXPO-CON/AGG tradeshow, which occurs once every three years, in Las Vegas during the week of March 22. The AGC Convention attracted more than 3000 members and featured presentations on pressing industry topics including Building Information Modeling, AIA and ConsensusDocs contracts, project crisis management, environmental issues, federal contracting laws, workplace safety, and social media. CONEXPO included more than 2400 exhibitors, 120,000 industry professionals, and a display of cutting edge construction equipment. Maltby concentrates his practice in the areas of construction, architectural, engineering and development law, business litigation, real estate litigation, and alternative dispute resolution (arbitration and mediation).

Meet Our Staff: Paralegal Joanne Adams

Joanne Adams is a paralegal in the estate planning department at CECB. Joanne was born and raised in San Diego, California. She moved to Ozark in July of 1993, and began working at Carnahan, Evans, Cantwell, & Brown in August of 1993.

Joanne's work includes drafting estate planning documents, managing trust and estate administration matters, as well as probate administration.

Joanne attended Palomar College in San Marcos, California. She is married to Scott Adams and they have one son, Chris, who is currently serving in the United States Air Force.

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Firm News

Molly C. Carnahan, Jenny C. Carnahan, John M. Carnahan III, and John C. Carnahan IV

Carnahan, Evans, Cantwell & Brown is pleased to announce that on Monday, March 21, 2011, Chief Justice John Roberts of the United States Supreme Court administered the oath for admission to practice before the United States Supreme Court, to John M. Carnahan III and other representatives of the University of Missouri School of Law. John is completing almost 6 and a half years of service to the University as a Member of its Governing Board of Curators. He is also a Fellow of the American College of Tax Counsel, has been designated to the Missouri-Kansas Super Lawyers list for the past five years, and formerly served as Chairperson of the Missouri Bar Section of Taxation.

John is a shareholder in the Transactional and Estate Planning Practice groups of CECB. He concentrates his practice in the areas of tax planning, corporate transactions, estate planning, and business succession planning for family-owned businesses.

The Firm is also pleased to announce that Jennifer K. Huckfeldt was recently accepted as a Fellow of the American College of Trust and Estate Counsel ("ACTEC"). The College is an organization of approximately 2,600 trust and estate lawyers and law professors who have been elected by their peers in recognition of having made outstanding contributions to the practice of estate and trust law. The College brings together the top lawyers in the profession to maintain a high quality of trust and estate legal services through mutual education; to create and foster networking among those lawyers based on the highest order of trust and confidence; and to contribute to the improvement of the areas of law in which trust and estate lawyers practice.

Jennifer is a shareholder in the Estate Planning Practice Group of CECB. She concentrates her practice in the areas of estate planning and administration and estate, gift, and income taxation.

Missouri Supreme Court Interprets 2007 Manufacturer's Sales Tax Exemption

by Frank C. Carnahan

The Missouri Supreme Court decision in *E & B Granite, Inc. V. Director of Revenue*, No. SC 91010, Feb. 8, 2011, granted a refund of sales and use tax paid under protest by E & B Granite, Inc. ("E & B") pursuant to section 144.054.2, RSMo Supp.2007.

Section 144.054.2 provides sales and use tax exemptions for:

[E]lectrical energy and gas, whether natural, artificial, or propane, water, coal, and energy sources, chemicals, machinery, equipment, and **materials** used or consumed in the manufacturing, processing, compounding, mining, or producing of **any product** ...."

The Supreme Court found that granite countertops manufactured by the taxpayer business were a "product" as required for application of exemption to taxpayer's purchaser of granite slabs for use in manufacture of countertops, even though countertops were eventually installed on customers' real property, and that the statutory language did not limit application of exemption to personal property sold ultimately for final consumption or tangible personal property, as compared with earlier-enacted sales and use tax exemption statute.

This changed the prior treatment under *Blevins v. Dir. of Revenue*, 938 S.W.2d 899, 901 (Mo. banc 1997). The asphalt company in that case sought tax exemptions under section 144.030.2(2), which exempts sales and use taxes on purchases of:

Materials, ... which when used in manufacturing ... become a component part or ingredient of the new personal property resulting from such manufacturing ... and **which new personal property is intended to be sold ultimately for final use or consumption,** ...

The Court noted that although sections 144.054.2 and 144.030.2(2) both relate to sales and use tax exemptions for manufacturers, there are two notable differences in the sections: (1) section 144.030.2(2) applies to "personal property ... sold ultimately for final consumption," and the legislature chose not to include this phrase in section 144.054.2; rather, section 144.054.2 broadly applies to "any product."; and (2) section 144.030.2(2) uses the phrase "new tangible personal property," and the legislature did not include any reference to "tangible personal property" in section 144.054.2. Moreover, section 144.054.2 exemptions are "in addition to any state and local sales tax exemption provided in section 144.030," indicating that the legislature intended to provide additional exemptions that are not allowed by section 144.030. In short, section 144.054.2 is broader than 144.030.2(2) and is not restricted by the phrases "personal property ... sold ultimately for final consumption" and "tangible personal property."

Manufacturers and contractors should review if they are entitled to a refund of taxes previously paid and tax due on returns going forward. ■

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Founded in 1979, Carnahan, Evans, Cantwell & Brown, P.C. is a locally owned and operated law firm noted for its commitment to providing superior client service to a diverse client base, including national and regional businesses, financial institutions, not for profit organizations and individual clients. The Firm currently has 19 attorneys, including eight who have their Master of Laws in Taxation. An "A-V rated" preeminent law firm by Martindale-Hubbell, our attorneys are engaged in the general business practice of law with an emphasis in the following areas:

- Business Organization and Planning
- Corporate
- Estate Planning
- Probate
- Trust Administration
- Transactions
- Real Estate
- Taxation
- Employee Benefits
- Banking
- Commercial Litigation and Dispute Resolution
- Environmental
- Intellectual Property
- Arbitration and Mediation
- Franchise
- Mechanics' Liens and Foreclosures
- Pension and Profit Sharing
- Employment
- Zoning and Land Development

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