Business Counseling UPDATE

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EMPLOYING ILLEGAL ALIENS PUTS YOUR BUSINESS AT RISK

Last year, the Immigration and Naturalization Service ("INS") began a coordinated effort with the Social Security Administration to crack down on illegal immigration. Since September 11, 2001, INS has been fighting for its bureaucratic existence against those in government who blame it for the security failures which resulted in the tragedies in Washington, D.C. and New York City. Right or wrong, since the passage of the 1996 Illegal Immigration Reform and Immigrant Responsibility Act (IIRIRA), Congress and the INS have passed to employers the job of preventing illegal aliens from finding work within the United States.

There is a nationwide push by INS to impose civil and criminal penalties personally against individual management and Human Resources personnel.

Unlike some Federal laws, such as the Civil Rights Act of 1964 and the Americans with Disabilities Act, the Immigration and Naturalization Act and IIRIRA apply to all employers regardless of size. It requires that employers ensure that a prospective employee is authorized to work in the U.S. prior to actually employing the individual. This requirement is strengthened by civil money penalties of up to $2,000 for each unauthorized individual employed. If the government can show multiple or repeat hiring on the part of the employer, criminal penalties may be imposed. These penalties are countered by anti-discrimination provisions which subject employers to civil

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penalties for discriminating against prospective employees on the basis of race or national origin. As such, employers nationwide are finding themselves in a "Catch-22" whereby they must be thorough to the point of suspicion in their review of employee authorization, but in doing so, they may not discriminate against the prospective employee.

In addition to penalizing the company actually employing the individual alien, there is a nationwide push by INS to impose civil and criminal penalties personally against individual management and human resources personnel. INS is becoming more proficient at coordinating its efforts with both the Social Security Administration and Internal Revenue Service to discover discrepancies in wage and withholding information to determine if an employee is authorized to work in the U.S. Lamson, Dugan & Murray has recently assisted clients in resolving criminal immigration charges. The time, expense, and risk involved in resolving a criminal or civil charge can be avoided by taking prophylactic steps to prevent such problems from arising in your business, and protecting the existence of the business you worked so hard to build.

Robert A. Mooney

Family Limited Liability Companies Continue to Offer Estate and Gift Tax Savings

Family limited partnerships (FLP) and family limited liability companies (FLLC) have been a mainstay of sophisticated estate and gift tax planning for some time now. Despite several legal challenges by the Internal Revenue Service, FLPs and FLLCs have been successfully used to lower estate and gift taxes through the use of valuation discounting.
In connection with gift tax planning, FLPs and FLLCs can successfully leverage your annual gift tax exclusion and unified credit exemption equivalent to pass more underlying value to the second and third generations without triggering gift tax. Lifetime gifting shifts future appreciation out of your taxable estate.

An FLP or FLLC involves the creation of a holding company, usually a limited liability company in Nebraska, which is funded with investment or business assets. Initially, one or both parents are the owners and are installed as the statutory manager of the company. Next, interests in the LLC are gifted to children and/or grandchildren.

Because interests in a closely-held LLC are valued for gift tax purposes at a discount from the underlying asset value of the LLC, more real value can be transferred within the confines of the $11,000 per year, per donee gift tax exclusion ($22,000 for married couples) and the $1,000,000 unified credit exemption equivalent. Since one or both parents serve as the manager of the LLC, you can retain control over the underlying assets of the company.

Additionally, we expect that FLPs and FLLCs will become an important part of estate tax planning in the coming years. While the estate tax portion of the unified credit will be increasing to $1,500,000 in 2004 (with additional increases between 2004 and 2009), that portion which may be used to shelter lifetime gifts will remain fixed at $1,000,000.

An FLP or FLLC involves the creation of a holding company, usually a limited liability company in Nebraska, which is funded with investment or business assets.

Additionally, FLPs and FLLCs can be formed in order to obtain the benefit of valuation discounts within your taxable estate. In contrast to a gift tax plan utilizing FLPs and FLLCs, in which the parents hold a controlling interest and serve as the managers thereby depressing the value of gifted interests, an estate tax plan may utilize FLPs and FLLCs with your children as managers and holding a controlling interest. With this configuration, the interest includible in your taxable estate may be eligible for valuation discounts, thereby generating estate tax savings in the 30% - 45% range.

Donald L. Erftmier Jr.

Tax Deferred Exchanges of Property

Because of the growing number of investment properties and their significant appreciation in value, more and more sellers are deferring their income tax liability by conducting exchanges under Internal Revenue Code §1031. Section 1031 permits taxpayers to exchange business or investment real estate for other investment or business property and defer paying capital gains tax as long as the property received is "like kind" to that transferred.

In October of 2000, the IRS issued Rev. Proc. 2000-37 which provides safe harbor provisions for Reverse Exchanges.

Generally there are three major types of exchanges: (1) a "Simultaneous" Exchange, whereby the taxpayer conveys business or investment property owned by the taxpayer ("Relinquished Property") and simultaneously acquires "like kind" property owned by a third party ("Replacement Property"); (2) a "Deferred Exchange", whereby the taxpayer conveys Relinquished Property and subsequently acquires Replacement Property; and (3) a "Reverse Exchange", whereby the taxpayer first acquires Replacement Property and thereafter conveys Relinquished Property.

In both a Simultaneous Exchange and a Deferred Exchange, the Replacement Property must be properly identified by the taxpayer within forty five (45) days of the closing of the sale of the Relinquished Property. Identification of Replacement Property is generally accomplished by timely delivering, mailing, faxing or sending a written document signed by the seller of the Relinquished Property that references the street address or the legal description of the proposed Replacement Property to any other person involved in the transaction. More than one Replacement Property may be identified if: (1) no more than three properties are identified; or (2) regardless of the number of properties identified, the total value of the properties identified is not more than twice the value of the Relinquished Property (200% of the value of the Relinquished Property). The Replacement Property must be acquired within one hundred eighty (180) days of the date of the closing of the Relinquished Property.

A taxpayer cannot have "actual or constructive" receipt of the funds from the sale of the Relinquished Property before the purchase of the Replacement Property. In a Simultaneous Exchange, the Relinquished Property is sold and the Replacement Property is purchased on the same day. While this is the simplest method, it is not always the most practical because it is often difficult to (1) find a buyer for the Relinquished Property, (2) find and identify suitable Replacement Property and (3) close into the same escrow on the same day. In a Deferred Exchange, an unrelated third party (an "Intermediary") is required to hold the funds until the Replacement Property is properly identified and purchased within the requisite time period. While this adds complexity to the transaction, it also provides the taxpayer additional time to find, identify and purchase Replacement Property since Replacement Property must be identified within 45 days of the closing of the Relinquished Property and purchased within 180 days of the closing of the Relinquished Property. Both methods allow a taxpayer to defer the recognition of gain on the exchange of Relinquished Property.

Until October of 2000, real estate professionals performed Reverse Exchanges without formal IRA guidance or approval. However, in October of 2000, the IRS issued Rev. Proc. 2000-37 ("Rev. 2000"), which provides safe harbor provisions for Reverse Exchanges. In a typical Reverse Exchange, the taxpayer desires to purchase the Replacement Property before the sale of the Relinquished Property. In order for that transaction to fall within the safe harbor established by Rev. 2000, the Replacement Property is transferred to a third party ("Accommodator"). The Accommodator holds "qualified indicia of ownership" in the property after closing. This is done in order to satisfy the safe harbor's requirement that qualified indicia of ownership of the property be held by a person who is (1) not the taxpayer nor (2) any other disqualified person. Outright legal title or other beneficial ownership such as a contract for deed interest satisfies this requirement.

No later than 5 business days after the transfer of qualified indicia of ownership to the Accommodator, the taxpayer and the Accommodator must enter into a written Qualified Exchange Accommodation Agreement ("QEAA"), which must provide that the Accommodator is holding the property for the benefit of the taxpayer in order to facilitate an exchange under § 1031 and Rev. 2000. It also must specify that the Accommodator will be treated as the beneficial owner of the property for all federal income tax purposes.

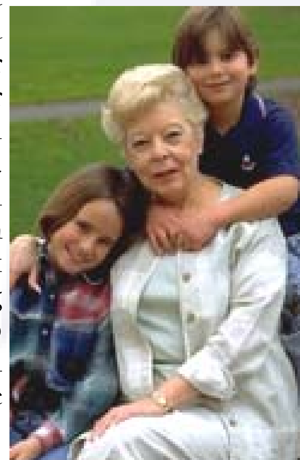
Within 45 days after the transfer of qualified indicia of ownership of the Replacement Property, the taxpayer must identify its applicable Relinquished Property in the same manner as required by the IRS for Deferred Exchanges. A third party must then purchase the Relinquished Property within 180 days of the transfer of qualified indicia of ownership of the Replacement Property. The combined period of time the Relinquished Property and the Replacement Property may be held in a QEAA by the Accommodator cannot exceed 180 days. Additionally, more than one piece of Relinquished Property may be exchanged in a Reverse Exchange as long as the transaction meets the same requirements described above in reference to Deferred Exchanges.

This article is intended to generally describe several options available to property owners who wish to sell business or investment property but desire to avoid unnecessary capital gains tax. It is crucial that if you do own property that may be exchanged pursuant to §1031, that these options are discussed prior to entering into any purchase agreement for the transfer of the property. A properly drafted real estate purchase agreement should, among other things, reference the fact that the seller or purchaser (as applicable) intends to effectuate a like kind exchange under §1031 and the other party to the transaction agrees to cooperate with the process.

Ryan N. Boe

Tax Savings With Charitable Bequests from Retirement Plans

Many individuals want to leave something to their favorite charities upon their deaths. In doing so, the source of the charitable bequest can impact the taxes paid by your estate and the amount other beneficiaries of your estate will receive. In most instances, a charitable bequest from a retirement plan provides the most tax savings, thereby passing the most money to beneficiaries and still honoring charitable bequests.



One of the primary benefits of retirement plans is that assets retained in them are not subject to income tax as they accumulate. However, retirement plan distributions received by the participant or beneficiary are subject to income tax at ordinary income tax rates. In addition, the full value of a retirement plan is included in the gross estate at the participant's death notwithstanding the fact that the retirement plan assets will be subjected to income tax upon receipt.

If your retirement plan is left to your children, the income taxes on those assets will eventually have to be paid.

Consequently, if your retirement plan is left to your children, the income taxes on those assets will eventually have to be paid. The income taxes can substantially reduce the total distributions your children will receive from your retirement plan. However, if your retirement plan is properly left to an eligible tax-exempt organization, those assets will pass income tax free and estate tax free to the charity.

If you have ever considered including a bequest to charity in your estate plan, examining the tax consequences of making the bequest from your retirement plan and the impact it will have on the amounts provided to other beneficiaries of your estate is worth the effort.

Angela M. Pelan

It's Never Christmas in the Commissioner's Office

IRS Announces New Audit Program

On October 28, 2002, the Internal Revenue Service announced that it will soon begin examinations of tax payer returns under its new National Research Program ("NRP"). The declared purpose of NRP is to obtain information about taxpayer compliance in a manner that is intended to be less intrusive than the old Taxpayer Compliance Measurement Program ("TCMP") which the IRS withdrew in 1994 because it was so time consuming and expensive for individual taxpayers who were subjected to a line-by-line examination and required substantiation of all information set forth on a return. Under the NRP, agents apparently will address only selected issues on a given tax return and will not require detailed documentation of every line on the return.

The declared purpose for the new NRP is to measure filing and payment compliance so that the IRS can update its audit selection formulas and focus on understanding the reasons for noncompliance. In short, the IRS needs to reprogram it's computers which is the first step in the selection process of a return for an audit.

Under the NRP, the IRS will randomly select 50,000 Forms 1040 for the 2001 calendar year to be studied and used to benchmark the IRS data bank. The IRS has declared that the returns selected will represent all income groups, geographic areas, and filings.

For each return selected, the Form 1040 will be analyzed and measured against other information already available to the IRS from other sources, such as information reporting on W-2 forms and Forms 1099 or that are otherwise commercially available from other data bases. The IRS has declared that if the return is a simple return and all of the information matches up, the Service will close the investigation without the taxpayer ever knowing that his/her return was selected for audit. The Service anticipates that that process is expected to apply to about 8,000 taxpayers.

The IRS has announced that there will be a second category of audits for approximately 9,000 returns where only one or two issues are selected for a review. It is anticipated that those returns will be audited via correspondence. The IRS has further announced that the correspondence audits will be conducted from the Kansas City Service Center.

The IRS will randomly select 50,000 Forms 1040 for the 2001 calendar year to be studied and used to benchmark the IRS data bank.

The third category of returns will be those returns where there are more than two or three issues. In those circumstances, there will be a personal audit conducted by a Revenue Agent or Tax Compliance Officer in a taxpayer's geographic area. The IRS states that they anticipate this third group of returns shall be very much like the typical audit which a taxpayer may experience today and will not require detailed documentation of every line on the return. The Service has stated that it anticipates that there will be approximately 30,000 of these limited scope audits, mostly with small business owners who report business activities on a Schedule C.

The IRS initiated the NRP program in early December. If your individual Form 1040 is selected for audit and you are notified of same in the near future, you should inquire of the Agent whether the return is part of a "routine audit" or is part of the new NRP program. As in any audit, you should probably immediately communicate with your tax counsel or other tax representative to be able to make sure that the audit is conducted in a manner that is not unduly burdensome for you or your business and to permit your tax advisor to work on limiting the scope of the audit process from the very beginning.

After the initial round of selecting 50,000 individual returns, the IRS intends to extend the NRP to corporate and partnership returns during the second year of the program and then to estates and trusts in the third phase of the program.

At the present time, it is simply too soon to know how the NRP audit process will play out. If the IRS follows its declared guidelines, the NRP should not be unduly burdensome for most taxpayers.

As in any audit, do not let the Revenue Agent conduct the audit at your home or place of business. Let your tax counsel or other tax advisor deal with the Revenue Agent and do not try to "charm", "intimidate" or otherwise deal with the Agent in a manner that is inappropriate. Most of those efforts are counter-productive.

Robert J. Murray

HIPAA

More Letters For Your Employment Law Alphabet Soup

The Health Insurance Portability and Accountability Act ("HIPAA") was amended by regulations governing the Standards of Privacy of Individually Identifiable Health Information ("Privacy Rules"), which took effect on April 14, 2001 and compliance is required by the Privacy Rules on April 14, 2003. The Privacy Rules will have an impact on how employers adopt and administer various employment policies and practices. Among other things, the Privacy Rules will impact how an employer determines whether an employee has a disability under the Americans With Disabilities Act ("ADA") and how employers may obtain medical certifications under the Family and Medical Leave Act ("FMLA").

If an employee refuses to turn over the requested medical information, he or she will be hard pressed to pursue any claim for ADA or FMLA rights against the employer.

Previously, under the ADA, an employer may have requested information directly from an employee's health care provider concerning the existence of a disability and/or the method of reasonable accommodation. Once the Privacy Rules come into effect, the employee's health care provider will be prohibited from disclosing information concerning an employee's health unless the employer obtains a HIPAA compliant authorization. Accordingly, in order for an employer to request medical information directly from a health care provider, the employee must complete a HIPAA authorization form before the medical provider will turn over the information. Alternatively, the employer may require the employee to obtain the requested medical information from the health care provider and then turn the information over to the employer. This avoids running afoul of the HIPAA authorization because the employee is receiving the medical information from the health care provider, not the employer.

Employers will also be required to obtain a HIPAA compliant authorization in order to obtain medical certifications under the FMLA. Much as the case with ADA issues, an employer will be required to obtain the employee's authorization prior to obtaining information from the health care provider to determine whether an employee's condition qualifies as an FMLA illness. This is true even for second and third opinions requested by the employer.

If an employer requests that the employee obtain the medical information, invariably the question will arise about an employee's refusal to turn over the medical information. If an employee refuses to turn over the requested medical information, he or she will be hard pressed to pursue any claim for ADA or FMLA rights against the employer.

In conclusion, employers must take care to ensure that their policies and procedures are updated to comply with HIPAA and that they are obtaining a HIPAA compliant authorization form when requesting medical information from an employee's health care provider.

Craig F. Martin

WORKERS' COMPENSATION INCREASE

Effective January 1, 2003, the maximum weekly benefit under the Nebraska Workers' Compensation Act became $542.00. This rate applies only to work related injuries and illnesses occurring on or after January 1, 2003. The previous maximum weekly benefit levels continue to apply to work related injuries occurring before January 1, 2003. The minimum weekly income benefit remains the same at $49.00.

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