August 2008 Newsletter of the Business Law Section of the State Bar of Texas

Message from the Chair

I am honored to be serving as Chair of the Business Law Section for the upcoming Bar year, and I hope that the services and opportunities provided by the Section will assist you in your practice. The 4,000 or so members of the Business Law Section consist of lawyers living in all parts of the State, with all levels of experience, from all sizes of firms, and we are continually looking for ways to better serve all of our members. This newsletter is one of the ways in which we have sought to use technology to enhance the value of your Section membership in recent years. We hope that you will find the information regarding the Section's activities as well as the updates and current legal developments to be helpful, and we welcome any suggestions you have for improving the usefulness of this newsletter or any other services of the Section to you.

In the coming year, the Section will be sponsoring or co-sponsoring various CLE programs for business lawyers (available at a discount to our members), and we will continue to seek the most relevant and useful articles for publication in the Business Law Journal. Our Website Committee is working hard on completing the upgrade of our website, and we hope to unveil the new website by the end of this year. As the 2009 legislative session unfolds, we will use our newsletter and other means of communication to help you stay abreast of proposed and new legislation in the business law area. As always, the ongoing work of our committees in drafting legislation, monitoring developments, and undertaking various other initiatives is at the heart of the Section's work, and we welcome your involvement. If you are interested in becoming involved in a committee and are unsure whom to contact, please do not hesitate to contact me.

Kindest regards,

Beth Miller

Chair, Business Law Section, 2008-2009

NEW FORM 990 – THIS CHANGES EVERYTHING

By: Frank Sommerville, JD, CPA

Weycer, Kaplan, Pulaski & Zuber, P.C.

Starting with tax years beginning on or after January 1, 2008, the IRS will require many nonprofit organizations to file a new Form 990. Nonprofit organizations will need to adjust their accounting systems now to provide the data required by the new form.

Why did the IRS redraft Form 990?

The IRS was seeking to accomplish three goals with the new Form 990. First, the form needed updating to accurately reflect how nonprofit organizations currently operate. This redraft allows the IRS to better monitor compliance with tax laws. Second, the IRS wanted to enhance the transparency of nonprofit organizations to the public. Specifically, the IRS wanted the public to know how nonprofit organizations operate and how they spend their contributions. Third and finally, the IRS wanted to minimize the tax filing burden on nonprofit organizations.

Who will be required to file the new Form 990?

For the 2008 tax year (returns filed in 2009), organizations with gross receipts over $1.0 million or total assets over $2.5 million will be required to file the new Form 990. For the 2009 tax year (returns filed in 2010), organizations with gross receipts over $500,000 or total assets over $1.25 million will be required to file the Form 990. The filing thresholds will be set permanently at $200,000 gross receipts and $500,000 total assets beginning with the 2010 tax year.

The IRS also announced a phase-in of the form's new hospital and tax exempt bond schedules. Certain identifying information will be required for the 2008 tax year, with completion of the entire schedules required for the 2009 tax year.

Organizations below the filing requirement for the new Form 990 will file Form 990-EZ. Also, the new Form 990 will not be required for private foundations and trusts.

What is so different about the new Form 990?

The biggest change involves the level of detail required from the nonprofit organization. The new Form 990 starts with an eleven page "core" form and adds schedules for certain situations. The new Form 990 asks thirty-seven questions to determine whether the organization needs to file one or more of the sixteen schedules. The IRS needed over 300 pages of instructions (in draft form) to explain the new form.

What do lawyers need to know about the new Form 990?

The new Form 990 asks a lot of questions regarding governance, policies, procedures, and compensation. While IRS has been criticized by the industry for asking questions that appear to be beyond the strict requirements of tax law, the IRS maintains that it is entitled to the answers to these highly detailed questions about state law matters. The IRS believes that good governance begets good tax compliance, while bad governance practices begets noncompliance with tax laws.

Since attorneys are frequently asked to draft or review articles of formation, bylaws, and minutes from board meetings, attorneys need to be familiar with the questions related to these topics. The questions ask how many voting members compose the governing body and how many are independent of each other. Another question asks whether contemporaneous minutes are kept and do they accurately reflect actions taken. The Form 990 also asks whether the organization's board reviewed and approved the Form 990 before it was filed. The question seeks information about who gave the Form 990 to the individual board members, when it was reviewed and what level of scrutiny that the board gave to the Form 990.

The revised form asks whether the organization has adopted a conflict of interest policy, a document retention policy and a whistleblower policy. Further, the IRS wants to know how the conflict of interest policy is monitored and enforced.

The IRS also wants to know whether the nonprofit organization invests in, contributes to, or participates in joint ventures. The IRS wants to know how the organization evaluates such opportunities and what steps the organization has taken to protect its tax exemption.

The IRS is seeking extensive information about related parties. The IRS believes that multiple related entities may lead to abuse. Since the instructions contain many different definitions of "related parties" for different purposes, attorneys should carefully review the new Form 990 instructions before advising nonprofit organizations about related party transactions and before creating new entities for nonprofit clients.

What information is needed about compensation?

Since attorneys are requested to draft employment agreements for nonprofit executives, they should be aware that compensation arrangements must be transparent. The IRS wants to know whether the nonprofit organization complies with the safe harbor for setting control party compensation contained in the intermediate sanctions regulations. This means that the organization secured comparable compensation data from reliable independent sources, the decision makers were all independent, and that contemporaneous minutes were kept of the meeting(s) where the compensation was set. These procedures need to be followed for all executives (CEO, Executive Director, officers and key employees) and their family members. Disclosure of compensation includes regular compensation, fringe benefits as well as both contributions to qualified and nonqualified plans and earnings increases in the plans.

Schedule J reports details about the compensation of employees who earn more than $150,000 annually. The IRS wants to know whether the organization provided first class or charter travel to these workers (this includes travel on the organization's airplanes and boats), travel for companions, tax indemnification or gross up payments, discretionary spending accounts, a personal residence, health or social club dues, or personal services provided by the organization's employees. This schedule also asks detailed questions regarding the organization's expense reimbursement policies and the level of documentation required before reimbursement is authorized.

In reporting compensation matters, the Schedule J asks for compensation paid by related parties, even if it is a for profit entity. While the definition of a related party covers where a majority of the board members are elected by another organization, it could also cover much more. The final version of the instructions (expected in late 2008) will hopefully clarify this issue.

What advice should attorneys give about Form 990 preparers?

Using the old Form 990, the IRS claimed that 27% of Form 990s had material errors. The error rate is expected to increase substantially. As a result, a key decision is the selection of the Form 990 preparer. Every Form 990 preparer will need to become intimately familiar with the new Form 990. Some attorneys and CPAs will need a continuing education course to acquire the necessary expertise. Nonprofit organizations should select a preparer who has extensive experience preparing Forms 990 and avoid those preparers who prepare just a few Form 990s. The new form is not for the faint hearted and it is anticipated that preparation time will double to triple.

Proposed Federal Legislation on Beneficial Ownership Reporting

By: Allan G. Donn (ABA Advisor to Record Owners of Business Act Drafting Committee)
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In response to reports by federal and international law enforcement agencies that the lack of business entity ownership information in state filing records impeded law enforcement efforts to combat money laundering, terrorism, and other criminal activity, in 2006 bills were introduced in Congress that would have added "persons involved in forming new corporations, limited liability companies, partnerships, trusts, or other legal entities" to the list included in the definition of "financial institutions" under 31 U.S.C. § 5312(a)(2) that are required to establish anti-money laundering programs pursuant to 31 U.S.C. § 5318(h).

In response to those bills, the National Association of Secretaries of State ("NASS") prepared a report of recommendations, including a request to the American Bar Association and the National Conference of Commissioners on Uniform State Laws ("NCCUSL") to amend the Model Business Corporation Act and uniform unincorporated business entity acts to require entities to file with the Secretary of State a periodic report that includes the name and address and natural person in the United States that has responsibility for providing access to the list of owners of record of a business entity.

Pursuant to that recommendation, the Committee on Corporate Laws of the ABA Business Law Section ("CCL") and NCCUSL undertook the preparation of amendments to the acts for which they were responsible. NCCUSL appointed a Drafting Committee for the Record Owners of Business Act that would include amendments to all of the NCCUSL sponsored uniform unincorporated organization acts, and the CCL undertook similar amendments to the Model Business Corporation Act ("MBCA").

ABA representatives met with representatives of a number of federal law enforcement agencies at the Treasury Department on several occasions in late 2007 before undertaking the drafting.

Two representatives of the Treasury participated in the January 19, 2008 meeting of the NCCUSL Drafting Committee. The basic approach of the Drafting Committee was to add the following provisions to the Uniform Acts:

1. An entity formed by filing with the Secretary of State must maintain a list of the names and addresses of its record owners.

2. The list must indicate for an owner that is not an individual:

a. If the owner is an entity, the jurisdiction of organization.

b. If the owner is a trust, the names and addresses of its trustees.

c. If the owner is a decedent's estate, the name and address of the personal representative.

3. The name and address in the United States of an individual that has access to the list of record owners must be included in the public filing that creates the entity, and the entity must file an annual report that states the current name and address of the individual with access to the list.

The Treasury representatives at the meeting said that their principal concern was with a U.S. entity having non-U.S. entity members as to which the government cannot identify the individual owners. To address that concern the NCCUSL draft requires that a non-U.S. entity member of a U.S. entity must provide the U.S. entity with a certificate of the name and U.S. address of an individual U.S. resident who will have access to the ownership information of the non-U.S. entity. That information must include the voting power held by each record owner of the non-U.S. entity.

Under the Drafting Committee's approach each U.S. entity would be required to maintain information regarding its record owners that would enable law enforcement agencies to trace ownership, step by step, including through multiple tiers of entities, to the individuals who have ultimate control. It would not require each U.S. entity to file with the Secretary of State the identity of the ultimate individual beneficial owners through multiple tiers.

The Treasury representatives advised the Chairman in early February that the Justice Department did not agree with the approach taken by the Drafting Committee and that it would recommend federal legislation.

On May 1, 2008 Senator Levin for himself and Senators Coleman and Obama introduced S.2956, "to prevent wrongdoers from exploiting United States corporations for criminal gain . . . and to assist law enforcement in determining, preventing, and punishing terrorism, money laundering . . . ." In the accompanying statement, he said that many states had been reluctant to admit that there was a problem with established U.S. business entities with unknown owners and that the NASS recommendation, rather than curing the problem, was full of deficiencies. He went on to say that he was deeply disappointed that the states, despite the passage of more than a year, had been unable to design an effective proposal.

The fundamental difference between S.2956 and the proposed amendments to the MBCA and the uniform unincorporated organization acts is that under the federal bill, at the time an entity is formed, there must be filed with the Secretary of State a report of the beneficial owners of the entity. A beneficial owner is "an individual who has a level of control over, or entitlement to, the funds or assets of a corporation or limited liability company that, as a practical matter, enables the individual, directly or indirectly to control, manage, or direct the ... company." (Proposed Sec. 2009(e)(1)). That information is required to be maintained currently, retained by the Secretary of State for five years after the entity terminates, and be made available to law enforcement agencies upon receipt of a subpoena or summons or written request by federal agencies on behalf of another country. If any beneficial owner is not a U.S. citizen or lawful permanent resident, the initial filing and each update must include a written certification by the formation agent that it has verified the name and identity of each beneficial owner and has obtained a copy of the government issued passport with a photograph of the beneficial owner. Excluded from the information filing requirement are entities that are registered under the Securities Exchange Act and any entity formed by them.

The NCCUSL Drafting Committee at its third meeting on June 7, 2008 continued its approach of drafting amendments to the uniform entity organization acts that would make record ownership information available to law enforcement agencies by identifying an individual who would be responsible for maintaining that information for each entity. That individual, to be designated the "Records Contact," will be identified in the filing upon the organization of the entity as well as in an annual report that will be filed. The draft does not require the filing of the identity of beneficial owners. The requirement for the Records Contact will apply only to a "closely-held company," that is, a company of not more than 50 members.

A draft of the Records Owners of Business Act, including only the amendments to the Revised Uniform Limited Liability Company Act (2006), was submitted for discussion, not adoption, at the NCCUSL annual meeting in July. Because the amendments to the other uniform acts will follow the same pattern, discussions of the LLC amendments should be sufficient to provide guidance to the Drafting Committee on the policy issues affecting all of the acts.

A copy of the draft and an accompanying memo prepared by the reporter, Harry Haynsworth, are available on the NCCUSL website at http://www.nccusl.org/Update/CommitteeSearchResults.aspx?committee=298.

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The Death of the Single Business Enterprise Theory?

In recent years, the single business enterprise theory has occupied an increasingly prominent role in Texas veil piercing jurisprudence. Under this theory, courts have permitted a claimant to reach the assets of a corporation's affiliate(s) (i.e, parent companies, commonly owned companies, or even individuals) to satisfy the liability of the corporation if the corporation and affiliate(s) have "integrated their resources for a common business purpose." The Texas Supreme Court has thus far declined to either endorse or disapprove of the single business enterprise theory as a basis to impose liability. *Southern Union Co. v. City of Edinburg*, 129 S.W.3d 74, 87 (Tex. 2003) ("We need not decide today whether a theory of 'single business enterprise' is a necessary addition to the theory of alter ego for disregarding corporate structure or the theories of joint venture, joint enterprise, or partnership for imposing joint and several liability."); *see also National Plan Administrators, Inc. v. National Health Ins. Co.*, 235 S.W.3d 695 (Tex. 2007) ("We do not reach the question of, and express no opinion on, whether the single-business enterprise theory is a viable doctrine to pierce the veil of an entity such as [the parent corporation of an entity that had allegedly breached a fiduciary duty to the plaintiff]."). In *Southern Union*, the court stated that it need not address the parameters of the single business enterprise theory because, whatever label was applied, the plaintiff's attempt to treat various entities as a single entity was encompassed within Article 2.21 of the Texas Business Corporation Act (TBCA), and the plaintiff failed to satisfy the actual fraud standard imposed by the statute. In other words, assuming the single business enterprise theory is a valid veil piercing theory, it falls within the scope of Article 2.21A(2) of the TBCA (or Section 21.223 of the Business Organizations Code), which requires a showing of actual fraud in order to hold a shareholder or affiliate liable for a corporation's contractual or contractually-related obligation on the basis of alter ego, actual fraud, constructive fraud, sham to perpetrate a fraud, "or other similar theory."

The single business enterprise theory has been used in the context of a court's exercise of personal jurisdiction in addition to serving as a means to impose liability on affiliates of a corporation. In ***PHC-Minden, L.P. v. Kimberley Clark Corp.***, 235 S.W.3d 163 (Tex. 2007), however, the Texas Supreme Court disapproved of the use of the single business enterprise veil piercing theory to impute contacts for purposes of the exercise of personal jurisdiction. The trial court in this case relied upon the single business enterprise theory to impute a parent company's "doing business" in Texas to a subsidiary Louisiana limited partnership in order to exercise personal jurisdiction over the Louisiana partnership. The court of appeals affirmed, concluding that the parent company and subsidiary limited partnership integrated their resources to achieve a common business purpose based on evidence that the two entities had at least one common employee, the parent paid certain employees of the subsidiary (although the salaries were inter-company payables), the subsidiary's name was similar to the parent company's name, the parent exercised control over the subsidiary's revenues and expenditures and oversaw certain activities, and the parent audited the subsidiary's financial goals to determine if the subsidiary would be able to meet the goals. The Texas Supreme Court once again pointed out that it has never endorsed the single business enterprise theory and has declined to decide whether it is a necessary addition to Texas veil piercing law. While the supreme court did not address the question of the validity of the single business enterprise theory in a case involving imposition of liability, the court rejected the single business enterprise theory as a basis for piercing in the personal jurisdiction context. The court distinguished between "jurisdictional veil piercing" (i.e, piercing for purposes of exercising personal jurisdiction) and "substantive piercing" (i.e., piercing for purposes of imposing liability) and stated that they involve different elements of proof. Specifically, the court stated that "fraud – which is vital to piercing the corporate veil under Section 21.223 of the Business Organizations Code – has no place in assessing contacts to determine personal jurisdiction." In addition, "some of the factors courts look to in determining whether an entity may be held liable as a "single business enterprise" are irrelevant to an analysis of jurisdictional contacts," according to the court. The relevant factors for jurisdictional veil-piercing were described by the court as follows:

To 'fuse' the parent company and its subsidiary for jurisdictional purposes, the plaintiffs must prove the parent controls the internal business operations and affairs of the subsidiary. But the degree of control the parent exercises must be greater than that normally associated with common ownership and directorship; the evidence must show that the two entities cease to be separate so that the corporate fiction should be disregarded to prevent fraud or injustice.

The evidence did not establish that the parent exercised the type of control over the limited partnership necessary to fuse them for jurisdictional purposes, and the court of appeals erred in imputing the parent's contacts to the limited partnership.

In ***Academy of Skills & Knowledge, Inc. v. Charter Schools, USA, Inc.***, __ S.W.3d __, 2008 WL 2514313 (Tex.App.–Tyler June 25, 2008, no pet. h.), the Tyler Court of Appeals discussed the

single business enterprise theory and, "taking the entirety of Texas law into consideration, and considering the supreme court's explicit lack of endorsement for the single business enterprise doctrine," held that the doctrine "does not exist under Texas law." Will other courts of appeals follow suit and reverse course with respect to the single business enterprise doctrine pending an ultimate answer from the Texas Supreme Court? It remains to be seen, but the Texas Supreme Court's apparent skepticism and the conclusion of the Tyler Court of Appeals indicate that the future viability of this veil piercing doctrine is very much in doubt.

UPDATE ON UCC 2 AND 2A

Chapters 2 and 2A of the Texas Business & Commerce Code, which govern the sale and leasing of goods, have not been updated since their original adoption by the Texas Legislature. Chapter 2 was adopted in Texas over 40 years ago. With the passage of time, it became apparent that some modifications were needed to clarify various provisions in these Chapters that have caused extensive litigation or confusion in business practice. After lengthy study and vetting over approximately ten years, proposed Amendments of Chapters 2 and 2A of the Uniform Commercial Code have been approved by the American Law Institute and the National Conference of Commissioners on Uniform State Laws ("NCCUSL").

The Article 2 and 2A Subcommittee, a subcommittee of the Commercial Code Committee of the Business Law Section, has carefully examined the proposed amendments over the last four years and has consulted with various industry and consumer interest groups for their feedback. From their review, the Subcommittee has proposed minor modifications of the NCCUSL amendments, particularly when the modifications are thought to be more in keeping with Texas law and beneficial for commerce.

Although the amendments of Chapters 2 and 2A are extensive, the Subcommittee concludes that most of them are not likely to cause a significant change in the substantive law because they reflect the better-reasoned judicial opinions that have interpreted the particular provisions or they are designed to bring Chapter 2 in line with current related statutory law. The proposed amendments are being considered by an interim study committee of the Texas House of Representatives.

On May 15, 2008, the Committee on Business and Industry of the Texas House of Representatives conducted a hearing to consider whether to amend Chapters 2 and 2A of the Texas Business & Commerce Code. A report of the Committee is expected to be completed in the fall.

securities law committee update

Almost a year ago, the SEC proposed significant changes to Regulation D, the primary exemption from registration of securities under the Securities Act of 1933. The highlights of those proposed changes included: 1) a new exemptive Rule 507 which would allow sales to "large accredited investors" using limited written (not broadcast) advertising; 2) a reduced time frame for a safe harbor from integration with other offerings from 6 months to 90 days; 3) some alternative "investments owned" benchmarks for qualifying as accredited and large accredited investors; and 4) a timetable and methodology for increasing the income and net worth benchmarks for qualifying as natural person accredited investors. (SEC Release 33-8828) Specifically, the SEC proposed that the income and net worth benchmarks for natural person accredited investors be indexed every five years to a general inflation index such as the consumer price index and that such indexing begin five years from the adoption of new rules set forth in the proposal release. This proposal represented the largest changes to private offerings since Regulation D was first adopted twenty five (25) years ago. It prompted 66 comments from a variety of interested parties including private firms, state regulators and certain lawyers who are members of the Securities Law Committee. Those comments can be found on the SEC website under File No s7-18-07. http://www.sec.gov/comments/s7-18-07/s71807.shtml

In January of 2008, John W. White, Director of the SEC's Division of Corporation Finance, stated in a speech that this initiative was on the Division's short list and he hoped to have final recommendations to the Commission soon. In early April 2008 at the Spring Meeting of the ABA's Section on Business Law, practitioners who had been in contact with SEC staffers working on the project stated that the SEC hoped to have a final rule out before the end of the summer. However, so far, there has been no further action by the SEC in this arena except to finalize and implement the electronic filing of Form D. There has been some speculation that there would be no action until the Commission had the full complement of Commissioners. The SEC, like other federal agencies, had been dealing with resignations of Commissioners in late 2007 and early 2008. However, the U.S. Senate confirmed three new Commissioners – Elisse Walter, Troy Paredes and Luis Aguilar – in late June. These Commissioners join Chairman Christopher Cox and Commissioner Kathleen Casey to round out the five seats on the SEC.

Venture Capital and Private Equity Committee UPDATE

As discussed in last months' newsletter, the Venture Capital and Private Equity Committee has formed a new subcommittee to focus exclusively on issues relating to the private equity

community. The subcommittee was formed in consideration of the large number of private equity funds that operate in the State of Texas and the vast number of private equity transactions that take place in the state. Any member of the Business Law Section who would like to join the Venture Capital and Private Equity Committee can do so by sending an email, with contact information, to Jason Villalba at jason.villalba@haynesboone.com with a copy to James A. Deeken, jdeeken@akingump.com.

Upcoming CLE Programs

The Section sponsors or co-sponsors several CLE programs each year. Discounts on registration fees are available to Section members on many of these programs. Upcoming CLE programs sponsored or co-sponsored by the Section include:

6th Annual Advanced Business Law Course 2008

Dallas, Texas --October 30-31, 2008

Presented by TexasBarCLE and sponsored by the Business Law Section. A $30 discount on the registration fee is available for all Business Law Section members. The program will be held at Cityplace Conference Center, 2711 Haskell Avenue, Dallas, Texas on October 30-31, 2008.

32nd Annual Conference on Securities Regulation and Business Law

Dallas, Texas--February 12-13, 2009

Presented by University of Texas CLE and sponsored by the Business Law Section. A discount on the registration fee will be available to Business Law Section members. The program will be held at the Belo Mansion, 7101 Ross Avenue, Dallas, Texas on February 12-13, 2009.