SEVENTEENTH
ANNUAL TAX SYMPOSIUM

October 18, 2008
SHERATON DETROIT NOVI
NOVI, MICHIGAN

PRESENTED BY THE LAW OFFICES OF
MADDIN, HAUSER, WARTELL, ROTH & HELLER, P.C.

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October 18, 2008

Dear Tax Symposium Participants:

Welcome to our Seventeenth Annual Tax Symposium. We are pleased that you have joined us this morning. This year's Tax Symposium will continue a format which begins with a general session and, after a brief refreshment break, concludes with two concurrent breakout sessions. You, of course, may select the breakout session which interests you or is most relevant to your practice.

As we've done historically, our Program will principally address tax issues and topics which we believe will help you better represent your clients. You will note, however, that we have included on our Program a topic which is of utmost concern to our clients and ourselves. With the failure or even possible failure of some of our banking institutions, the scope of FDIC coverage presents daily inquiries. This session provides you with some suggestion which will allow you or your clients to maximize their FDIC coverage.

While our Annual Tax Symposium features many of the tax and corporate members of the firm, you should be aware that we are a "full service law firm." Please visit our website at www.maddinhauser.com to find out more about the firm. As always, we appreciate your attendance at this program and welcome your comments and suggestions.

Very truly yours,

MADDIN, HAUSER, WARTELL,
ROTH & HELLER, P.C.

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SEVENTEENTH ANNUAL TAX SYMPOSIUM PROGRAM

GENERAL SESSION

Registration and Breakfast	**8:00 - 8:30**	
MARK R. HAUSER – Opening Remarks	**8:30 - 8:35**	
STUART M. BORDMAN **Dividing the Empire**	**8:35 – 9:10**	**Page 1**
WILLIAM E. SIGLER **Hot Tax Topics**	**9:10 – 9:45**	**Page 10**
COURTNEY D. ROSCHEK **Mix It Up: A Quick Guide to Maximizing FDIC Insurance Coverage**	**9:45 – 10:05**	**Page 60**
RICHARD F. ROTH **Tax Effects of Divorce and Postnuptial Trusts to Avoid Divorce**	**10:05 – 10:35**	**Page 74**
Question and Answer ---	**10:35 – 10:45**	
Break	**10:45 –11:00**	

BREAKOUT SESSION A

ROBERT D. KAPLOW **The Grim Reaper Cometh: Planning for Terminal or Elderly Clients**	**11:00 –11:25**	**Page 103**
GEORGE V. CASSAR **Making the Continuation of Your Business A Success**	**11:25 –11:50**	**Page 126**
GEOFFREY N. TAYLOR **Residence GRITS – YUMMY YUMMY!**	**11:50 –12:15**	**Page 142**
Question and Answer	**12:15-12:30**	

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BREAKOUT SESSION B		
<u>GARY M. REMER</u> What is the IRS Looking For On Retirement Plan Audits	11:00 –11:25	Page 150
<u>MARC S. WISE</u> Simple Mathematics – Health Care Financing Options and IRS Testing Requirements	11:25 –11:50	Page 175
<u>CHARLES M. LAX</u> Qualified Retirement Plan Update – Five Things You Should Be Aware Of	11:50 –12:15	Page 193
Question and Answer	12:15 –12:30	

GENERAL INFORMATION	
Attorneys' Biographies	Page 213
Seminar Qualifies for Four CPE Credits	

DIVIDING THE EMPIRE

By: Stuart M. Bordman

I. <u>CONSEQUENCES UPON EXCHANGE OF STOCK / MEMBERSHIP INTEREST (THE "OWNERSHIP INTEREST")</u>

A. Section 355 of the IRC (Distribution of Stock and Securities of a Controlled Corporation) which would allow for a tax free division of a corporation is not available.

B. The exchange of interests will be taxable. Gain will be equal to the excess of the fair market value of the ownership interest received over the basis of the ownership interest relinquished.

C. Basis of "S" corporate stock and membership interest.

1. Does accountant maintain a work paper with basis updated annually?

2. Does accountant have tax returns and other information which would permit the accountant to do a basis study?

II. <u>APPRAISAL FOR DETERMINING FAIR MARKET VALUE OF OWNERSHIP INTEREST ACQUIRED</u>

A. Preparer Penalty under Section 6695 for substantial and gross valuation understatements attributable to incorrect appraisal.

1. A person prepares an appraisal.

2. The person knows the appraisal will be used in connection with a return.

3. The claimed value on the return results in a substantial valuation misstatement within the meaning of Section 6662(e).

4. The person is subject to a penalty equal to the lesser of:

   a. The greater of 10% of the amount of the underpayment as defined in Section 6664(a) or $1,000; or

   b. 125% of the income received for preparation of the appraisal.

B. No penalty will be imposed if the appraiser establishes to the satisfaction of the Secretary that the value established in the appraisal is more likely than not to be proper value.

III. <u>SECTION 6662 IMPOSITION OF ACCURACY – RELATED PENALTY ON UNDERSTATEMENTS AND MISSTATEMENTS</u>

A. Taxpayer is subject to a penalty equal to 20% of the underpayment to which Section 6662 applies.

B. There is a substantial understatement if the understatement exceeds the greater of:

   1. 10% of the tax required to be shown on the return; or

   2. $5,000 [**Note:** Special rules for corporations].

C. There is a substantial misstatement penalty imposed under Section 6662 (e) if the value of the property claimed on a tax return is 150% or more of the amount determined to be the correct amount of the valuation.

D. Penalty is reduced if there is:

   1. Disclosure.

   2. Reasonable basis.

IV. PREPARER PENALTIES BEFORE AND AFTER THE SMALL BUSINESS AND WORK OPPORTUNITY TAX ACT OF 2007 (THE "ACT")

A. Goals of the Act (Notice 2008-13).

1. Extend the application of income tax preparer penalties to all tax return preparers.

2. Make more stringent the standards of conduct that must be met to avoid imposition of the 6694(a) penalties for preparing a return which reflects an understatement of liability.

3. Increase applicable penalties under Section 6994(a) and 6694(b).

	BEFORE	AFTER [1]
Applicable to:	Income tax returns and claims for refund.	Income, estate, gift, employment, excise and exempt organization returns and claims for refund.
Definition of Preparer:	Person who prepared for compensation an income tax return or claim for refund, or a substantial portion of an income tax return or claim for refund.[2]	See B below.
Undisclosed Positions:	Penalty imposed if there was not a realistic possibility of the position taken being sustained on its merits. A person knowledgeable in tax law must conclude that the position has an approximately one in three or greater likelihood of being sustained on its merits. No consideration can be given to the possibility of no audit or the fact the issue is not raised on audit.	Penalty imposed unless the preparer has a reasonable belief that the tax treatment of the position is more likely than not ("MLTN") proper.

Disclosed Position:	Penalty imposed if the preparer knew or reasonably should have known the position taken was frivolous.	Penalty imposed unless there is a reasonable basis for tax treatment.
Penalty:	$250	Greater of $1,000 or 50% of the income derived or to be derived by the preparer with respect to the return or claim for refund.
Penalty for Understatement Due to Willful or Reckless Conduct:	$1,000	Greater of $5,000 or 50% of the income derived or to be derived by the preparer with respect to the return or claim for refund.
Reasonable Cause Exception:	No penalty if there is reasonable cause and the preparer acted in good faith.	No penalty if there is reasonable cause and the preparer acted in good faith.

1 Effective for tax returns and claims for refund prepared after May 25, 2007 but there are some transitional rules.

2 Whether a portion is substantial is determined by the facts and circumstances. Thus, a single entry can be substantial. For example, a single, large capital gain for which a non-signing preparer is responsible can constitute a substantial portion of a return and subject the non-signing preparer to a penalty if the IRS determines that there is an understatement attributable to the computation of the capital gain.

B. Who is a preparer? IRC 7701(a)(36).

1. In general, the term "tax return preparer" means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax or any claim for refund of tax. For purposes of the preceding sentence, the preparation of a substantial portion of a return or

claim for refund shall be treated as if it were the preparation of such return or claim for refund.

2. Exceptions. A person shall not be a "tax return preparer" merely because such person :

    a. furnishes typing, reproducing, or other mechanical assistance;

    b. prepares a return or claim for refund of the employer (or of an officer or employee of the employer) by whom he is regularly and continuously employed;

    c. prepares as a fiduciary a return or claim for refund for any person; or

    d. prepares a claim for refund for a taxpayer in response to any notice of deficiency issued to such taxpayer or in response to any waiver of restriction after the commencement of an audit of such taxpayer or another taxpayer if a determination in such audit of such other taxpayer directly or indirectly affects the tax liability of such taxpayer.

C. An advisor who gives tax planning advice on a prospective transaction and who does not address issues after the transaction is completed is not subject to the preparer penalty.

D. An information return that reports information that is or may be reported on another tax return may subject the information return preparer to the Section 6694(a) penalty if the information reported constitutes a substantial portion of the other tax return.

1. Form 1065, U.S. Return of Partnership Income (including Schedules K-1);

2. Form 1120S, U.S. Income Tax Return for an S Corporation (including Schedules K-1); and

3. Form 5500, Annual Report/Report of Employee Benefit Plan.

See Notice 2008-13, Exhibit 2, for additional information returns that may subject a preparer to the Section 6694(a) penalty.

E. Assessment of a preparer penalty will result in an automatic referral to the Office of Professional Responsibility for consideration of whether the preparer should retain the right to practice before the IRS.

F. Adequate disclosure of a tax return position that meets the reasonable basis standard, but not the MLTN standard, avoids the Sec. 6694(a) preparer penalty. Basically, adequate disclosure is made by (1) properly reporting the item on the return, or (2) filing a Form 8275 (Disclosure Statement) or Form 8275-R (Regulation Disclosure Statement).

MEMORANDUM

TO: GEOFFREY N. TAYLOR
FROM: STUART M. BORDMAN
DATE: OCTOBER 15, 2008
RE: THE DENTAL EMPIRE
COMPLETION DATE: 10:00 a.m., Saturday, October 18, 2008, which is the time and date for your meeting with Whitefang. (I am leaving for the Galapagos tomorrow.)

On July 1, 2008, we were retained by Whitefang DDS to represent him in his separation from Blacktooth, DDS. Information regarding income and ownership is set forth below.

Corporation	Ownership Whitefang/ Blacktooth/Brush	2007 Income	Current Debt	Lease
A	50/50	$1,000,000[1]		No
B	50/50	300,000[2]		3 Years
C	50/50	300,000[2]	$40,000[3]	5 Years
D	35/35/30	400,000[2]		Landlord to demolish building.
E [4]	50/50	[$100,000]	220,000[3]	No
F [5]	50/50	- 0 -	50,000[3]	1 Year[3]

1. Includes add back of all shareholder compensation.

2. No compensation to shareholders.

3. Guaranteed by Whitefang and Blacktooth.

4. Clinic is closed. Receivables will be collected and equipment sold to reduce bank debt.

5. Clinic is closed. Receivables will be collected and equipment has been sold to reduce bank debt and the amount due pursuant to the lease.

NOTE: All entities are cash basis calendar year "S" corporations.

Because of concerns about malpractice judgments in excess of policy limits, Whitefang and Blacktooth formed a new entity for each dental clinic.

Clinics A, B, C and D are very successful. Whitefang and Blacktooth treat patients on a very limited basis and devote the balance of their time to the promotion, administration and business affairs of the dental clinics.

Blacktooth views himself as a mover and shaker and wants to open a dental clinic in every strip center with a vacant store. Two clinics opened at the insistence of Dr. Blacktooth (E and F) failed, Whitefang and Blacktooth lost their investment and were left with a large amount of personally guaranteed debt. Whitefang is comfortable with the four (4) clinics presently owned and is willing to open additional clinics when a good location is available. Because Whitefang would not agree with the expansion plans at Blacktooth's pace, Blacktooth (with the knowledge of Whitefang) has opened clinics without the involvement of Whitefang. However, in order to further his expansion, Blacktooth has used personnel employed by the jointly owned clinics and has otherwise used the jointly owned clinics as a launching pad.

Matters came to a head recently when Blacktooth needed money for his clinics and he unilaterally paid dividends from the S corporations. I am certain Blacktooth had counsel because all amounts were distributed based upon stock ownership. While Whitefang received his share of the cash that was distributed, so much cash was taken that the clinics will have a difficult time operating. Because its bank account was drained, Clinic C had to draw on its line of credit to continue operations.

Michelle Harrell of our office obtained a Temporary Restraining Order against Blacktooth preventing him from distributing any more money from any of the clinics and from using any resources of the clinics to assist in his expansion plans.

We are now negotiating to see who ends up with which of the clinics. The questions for you to research and discuss with Whitefang are as follows:

1. Is there any way to use Section 355 of the Internal Revenue Code and have a tax free split off?
2. Assuming interests are exchanged, how is income allocated and how does the tax year end with respect to the shareholder who relinquished his stock?
3. Since the accounting is always behind, can the parties exchange interests at this time with an effective date of September 30, 2008?
4. Will gain be capital or ordinary?
5. What is the measure of gain?
6. Should we use an appraiser to establish fair market value?
7. Once the appraiser establishes fair market value, can we take a discount for minority interest and/or lack of marketability?

8. Can we be deemed a preparer if we supply the accountant with the values to be used in preparing Whitefang's income tax return?

9. If an appraiser is not used and the accountant comes up with fair market value, is he subject to a preparer penalty if the IRS determines the amount on the return is understated?

Please furnish me with a memo summarizing your conclusions and your meeting with Whitefang.

HOT TAX TOPICS

By: William E. Sigler

I. FEDERAL

A. Mileage Reimbursement Rates. Just before July 4, the IRS announced some very good news for businesses and individuals struggling with record-high gasoline prices. The IRS raised the business standard mileage reimbursement rate from 50.5 cents per mile to 58.5 cents per mile. It also raised the standard mileage rate for medical and moving expenses from 19 cents per mile to 27 cents per mile. However, the charitable standard mileage rate remains at 14 cents per mile. Taxpayers may use the higher rate for business use of an automobile (and the higher medical/moving rate) for the period July 1, 2008 through December 31, 2008. Travel before July 1 must be computed using the old rate of 50.5 cents-per-mile.

B. Economic Stimulus Payments. The Treasury Department and the IRS have distributed more than 100 million economic stimulus payments to qualifying Americans. Despite some minor glitches, most qualifying individuals have received, or will soon receive, their payments. However, millions of qualifying taxpayers, especially seniors and disabled veterans, have not yet filed a 2007 return to claim a payment. When Congress authorized the economic stimulus payments in January, it also approved temporary 50-percent bonus depreciation. Many taxpayers have been asking for clarification about this bonus depreciation and in April, the IRS announced that it will issue guidance sometime in 2008. In the meantime, the IRS indicated that businesses can rely on temporary regs from 2003.

C. Two New Tax Laws. Just before Memorial Day, Congress passed two new tax laws: a comprehensive farm bill and a military tax relief act. Both include significant tax incentives. The farm bill, among other things, creates new tax credits for securing agricultural chemicals and cellulosic fuels along with authorizing new forestry conservation bonds. The military bill, among other things, allows reservists called to active duty to make penalty-free withdrawals from IRAs, 401(k)s and other arrangements and creates a temporary differential pay tax credit for small employers. While the tax provisions in the farm and military acts are targeted to farmers and military personnel, the offsets are more wide-reaching. Lawmakers needed to find billions of dollars to pay for the tax cuts. They used some of the least controversial offsets (tougher rules on U.S. government contractors and individuals who renounce their U.S. citizenship, limiting farm losses and reducing the ethanol production tax credit), leaving more controversial offsets, particularly a proposed change in the taxation of "carried interest," to possibly pay for future tax cuts.

D. Pending Legislation. Congress continues to debate the so-called "extenders bill," which would extend many popular but temporary tax cuts. These include the alternative minimum tax (AMT) "patch," the state and local sales tax deduction, energy tax incentives, and employer tax breaks. The House version of the extenders bill would also expand the refundable child tax credit. Under current law, the credit is refundable to the extent of 15 percent of the taxpayer's earned income in excess of a $10,000 floor ($12,050 as adjusted for inflation for 2008). The bill reduces the floor to $8,500 for 2008. Additionally, Congress must approve an IRS budget for FY 2009. We'll keep you posted of developments with all the pending bills.

E. Health Savings Accounts. Health Savings Accounts (HSAs) are one of the fast-growing ways to save for health care. Distributions from an HSA, which are used for qualified medical expenses, are tax-free. In May, the IRS announced new 2009 inflation adjustments for HSAs. The annual limit on deductible contributions to an HSA will rise to $3,000 for 2009, up from $2,900 for 2008. This limit applies to an individual with self-only coverage under a high-deductible health plan (HDHP). The annual limit for deductible contributions for an individual with family coverage under a HDHP will rise to $5,950 for 2009, up from $5,800 for 2008. The deduction limits for self-only and family coverage are indexed for inflation. Individuals who are 55 and older may also make a catch-up contribution of $1,000, up from $900 in 2008.

F. Tax Gap. According to the IRS, the difference between what taxpayers owe and what they actually pay is about $300 billion. This is called the "tax gap." The IRS is using many tools to help close the tax gap. One tool is education. In April, the IRS launched a campaign to educate self-employed small business owners about their federal tax responsibilities. The campaign will provide new Schedule C, Profit or Loss from Business, filers with improved and updated educational materials through its web site, small business workshops and other outreach events.

G. Tax Shelters. The IRS has invested huge resources into combating abusive tax shelters. Often, taxpayers agree to settle rather than try to fight the IRS in court. However, some cases do go to trial. The IRS won several tax shelter cases in the second quarter of 2008, but also suffered some setbacks. In April, a federal court rejected the IRS's argument that a transaction (called Son of BOSS) was an abusive tax shelter. *CCH Federal Tax Weekly*, No. 18, May 1, 2008. A few weeks later, another court found that a similar Son of BOSS transaction was an abusive tax shelter. *CCH Federal Tax Weekly*, No. 21, May 22, 2008. A short time later, yet another court found that a Sale In, Lease Out (SILO) transaction was an abusive tax shelter. *CCH Federal Tax Weekly*, No. 23, June 5, 2008. So it's been a mixed bag of successes and setbacks for the IRS. Nonetheless, the IRS has vowed to continue litigating these complex tax shelter cases.

H. Mortgage Debt Forgiveness. The IRS released an updated version of *IRS Publication* 4681, *Canceled Debts, Foreclosures, Repossessions and*

Abandonments. It explains the rules that currently apply for canceled debt on a principal residence. In general, a taxpayer realizes income when debt is forgiven. There are several exceptions and exclusions that may result in all or part of a taxpayer's income from the cancellation of debt being nontaxable. For example, the Mortgage Relief Act, effective for indebtedness discharged on or after Jan. 1, 2007 and before Jan. 1, 2010, generally allows taxpayers to exclude up to $2 million of mortgage debt forgiveness on their principal residence. The exclusion is claimed by filling out Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), and attaching it to the taxpayer's applicable income tax return. The new IRS publication also explains the tax treatment of foreclosures and abandonments of residences.

I. Housing and Economic Recovery Act of 2008. President Bush signed the Housing and Economic Recovery Act of 2008 on July 30, 2008. This legislation is a direct response to the continued decline in the housing market and its overall effect on the nation's economy. The tax provisions in the bill enact significant changes even though they are only one part of the larger housing bill. The tax title, The Housing Assistance Tax Act of 2008 ("the Act") includes $15.1 billion in tax incentives that are completely offset by revenue raisers. The real estate-specific tax incentives focus on home ownership and affordable housing, while the offsets to these incentives are obtained from a range of sources.

1. First-Time Homebuyers Credit. The Act entitles first-time homebuyers (i.e., those who have not owned a principal residence in the United States for three years preceding the current home purchase) to a temporary refundable credit equal to 10% of the purchase price of a home, up to $7,500 ($3,750 for a married individual filing separately). The new credit is effective for qualifying home purchases made on or after April 9, 2008, and before July 1,

2009. The credit will be subject to a phaseout for taxpayers with a modified adjusted gross income in excess of $75,000 ($150,000 for married persons filing jointly). Although this benefit is called the "first-time homebuyer credit," the use of the term "credit" is misleading. The credit basically functions as a no-interest loan. Homeowners who take advantage of this credit must repay the credit over a 15-year period even if they continue to own and live in the home. The repayment process, which begins two years after the principal residence purchase, will add $500 to the homeowner's tax bill each year for 15 years. If the homeowner sells or no longer uses the home as his or her principal residence before repaying the credit, the unpaid balance becomes due in the year this event occurs. However, the credit does not have to be repaid if the homeowner dies. In addition, there are special rules for involuntary conversions of the residence, as well as a residence transferred pursuant to a divorce.

2. Additional Standard Deduction for State and Local Property Taxes. This provision of the Act targets homeowners who claim the basic standard deduction, instead of itemized deductions, on their individual tax returns. Taxpayers cannot take the standard deduction if they claim itemized deductions. Taxpayers who itemize their deductions may deduct state and local taxes paid, including individual income taxes, real property taxes and personal property taxes. The Act gives homeowners a limited deduction for state and local real property taxes by increasing the amount of their standard deduction by the lesser of:

- the amount of real property taxes paid during the year, or
- $500 ($1,000 for a married couple filing jointly).

This is a temporary deduction that is available only for 2008. Homeowners that may benefit from this deduction include those who have paid off their mortgage and are no longer itemizing their deductions. For tax planning purposes, the 2008 standard deduction for a married couple filing jointly would increase from $10,900 to $11,900, while the deduction for single individuals would increase from $5,450 to $5,950.

3. Reduced Home Sale Exclusion. Under current tax law, a homeowner may generally exclude from income up to $250,000 of gain ($500,000 on a married filing jointly return in most cases) realized on the sale of a principal residence as long as the residence was owned and used for two out of the last five years. The general rule also allows for a partial exclusion if the ownership and use test is not met. The Act changes this general rule by excluding periods of "non-qualifying use" during the five-year period before a principal residence is sold. This provision applies to residences sold after December 31, 2008. Starting on January 1, 2009, homeowners who use their home as a vacation home or for rental for some time will no longer be able to exclude the portion of the gain allocated to such nonqualified use. Fortunately, any nonqualified use prior to 2009 does not count. Certain use is not treated as nonqualified use, including leaving the home vacant and temporary absences due to a change in employment, health or unforeseen circumstances. The following example illustrates the Act's new provision: Mr. and Mrs. Jackson buy a home on January 1, 2009 and rent it for two years. On January 1, 2011, the Jacksons begin to use their home as a principal residence. They move out of the house on January 1, 2013, due to a change in Mr. Jackson's employment, and sell it for $800,000 on January 1, 2014. The period from 2009 to 2010 is a non-qualifying use period. 2013 is counted as a qualifying use period because of Mr. Jackson's change of employment. Of the $400,000 gain, 40% (two years out of five), or $160,000, is not eligible for the exclusion. The $240,000

balance of the gain ($400,000 minus $160,000) is excluded. Thus, the Jacksons would recognize a $160,000 capital gain on the sale of the home. As the example above illustrates, significant tax planning measures will need to take place for sales of homes with post-January 1, 2009 non-qualifying use.

4. Protection of Taxpayer Social Security Numbers in Real Estate Transactions. Under current law, an individual selling a home is required to provide the purchaser of the home with an affidavit stating, under penalties of perjury, that the seller is not a nonresident alien individual or a foreign corporation (special tax rules apply to sales of real estate by nonresident alien individuals and foreign corporations). This affidavit must contain the seller's Social Security number. In order to protect individuals from identity theft that could occur in connection with the sale of real estate, the bill will allow the seller to provide this affidavit to the business professional responsible for closing the real estate transaction (e.g., an attorney or title company) instead of sending this affidavit to the purchaser.

5. Election to Accelerate Recognition of Historic AMT/R&D Credits. The bill would allow taxpayers to elect to accelerate the recognition of a portion of their historic AMT or research and development (R&D) credits in lieu of the bonus depreciation tax benefit that was included in the Economic Stimulus Act of 2008. The amount that taxpayers receive is calculated based on the amount that each taxpayer invests in property that would otherwise qualify for bonus depreciation under the Economic Stimulus Act of 2008. This amount is capped at the lesser of 6% of historic AMT and R&D credits or $30 million.

6. Information Returns for Merchant Payment Card Reimbursements. The bill would enact a proposal contained in the President's FY 2009 Budget to require institutions that make payments to merchants in settlement of payment card transactions to file an information return with the Internal Revenue Service. According to the Treasury Department, "Payment cards (both credit cards and debit cards) are an increasingly common form of payment to merchants for property and services rendered. Some merchants fail to report accurately their gross income, including income derived from payment card transactions. Generally, compliance increases significantly for amounts that a third party reports to the IRS." The bill would also require information returns for payments in settlement of certain third party network transactions that operate in a manner similar to payment card transactions.

7. Delay Implementation of Worldwide Allocation of Interest. In 2004, Congress provided taxpayers with an election to take advantage of a liberalized rule for allocating interest expense between United States sources and foreign sources for purposes of determining a taxpayer's foreign tax credit limitation. Although enacted in 2004, this election is not available to taxpayers until taxable years beginning after 2008. The bill would delay the phase-in of this new liberalized rule for two years (for taxable years beginning after 2010). Special transition rules would apply in the first year that the liberalized rule phases in. The House of Representatives has voted on a bipartisan basis to delay the implementation of this future tax benefit in order to provide current tax relief numerous times: as part of H.R. 3920 by a vote of 264 to 157 (with 38 House Republicans joining 226 House Democrats in support); as part of H.R. 3221 by a vote of 322 to 94 (with 95 House Republicans joining 227 House Democrats in support); and as part of H.R. 6049 by a vote of 263-

160 (with 35 House Republicans joining 228 House Democrats in support).

8. Other Provisions. The Act contains other provisions designed to simplify the low-income housing tax credit and the rules for tax-exempt housing bonds. In addition, the Act temporarily expands the mortgage revenue bond program to permit the refinancing of existing subprime loans, and includes real estate investment trust (REIT) reforms.

J. AMT Relief; Extenders. As we go to press, Congress is considering major tax legislation featuring AMT relief, extension of a host of expired personal and business tax breaks, disaster relief, and various energy provisions.

1. AMT Patch. Currently, a taxpayer receives an exemption of $33, 750 (individuals) and $45,000 (married filing jointly) under the AMT. Current law also does not allow personal credits against the AMT. At the end of last year, H.R. 3996 increased the exemptions to $44,350 and $66,250, respectively, and allowed the personal credits against the AMT to hold the number of taxpayers subject to the AMT at bay. The provision expired December 31, 2007. This proposal increases the exemption amounts to $46,200 (individuals) and $69,950 (married filing jointly) for 2008. The proposal will also allow the personal credits against the AMT.

2. Veteran Mortgage Bonds. Qualified mortgage bonds may be issued to finance mortgages for veterans who served in active military without regard to the first-time homebuyer requirement. This exception expired on December 31, 2007. The proposal extends the provision to the end of 2009.

3. EITC Combat Pay Election. To maximize the earned income tax credit (EITC), a service member may elect to include combat pay

as earned income for purposes of EITC. This provision expired on December 31, 2007. The proposal extends the provision to the end of 2009.

4. Penalty-Free Withdrawals from IRAs for Reservists. A Reservist may make an early withdrawal from a retirement plan without triggering a 10% early withdrawal tax and a Reservist has two years from the last day of the active duty period to contribute distributions to an IRA. This exception expired on December 31, 2007. The proposal extends the provision to the end of 2009.

5. Deduction of State and Local General Sales Taxes. The American Jobs Creation Act (AJCA) provided that a taxpayer may elect to take an itemized deduction for state and local general sales taxes in lieu of the state and local income tax itemized deduction. The provision expired December 31, 2007. The proposal would extend the provision to the end of 2009.

6. Qualified Tuition Deduction. Economic Growth Tax Relief Reconciliation Act created an above-the-line tax deduction for qualified higher education expenses. The maximum deduction was $4,000 for taxpayers with Annual Gross Income (AGI) of $65,000 or less ($130,000 for joint returns) or $2,000 for taxpayers with AGI of $80,000 or less ($160,000 for joint returns). This deduction expired December 31, 2007. The proposal would extend the deduction to the end of 2009.

7. IRA Rollover Provision. Allows taxpayers to make tax free contributions from their IRA plans to qualified charitable organizations. This tax benefit expired December 31, 2007. The proposal would extend the provision to the end of 2009.

8. Teacher Expense Deduction. Teachers are allowed an above-the-line deduction for up to $250 for educational expenses. This provision expired December 31, 2007. The proposal extends the deduction to the end of 2009.

9. Treatment of Certain Dividends of RICs. Under present law, a Related Investment Company (RIC) may, under certain circumstances, designate all or a portion of a dividend as an "interest-related dividend," by written notice mailed to its shareholders not later than 60 days after the close of its taxable year. In addition, an interest-related dividend received by a foreign person generally is exempt from U.S. gross-basis tax under sections 871(a), 881, 1441 and 1442 of the Code. The proposal extends the treatment of interest-related dividends and short-term capital gain dividends received by a RIC to taxable years of the RIC beginning before January 1, 2009.

10. Encourage Contributions of Property Interests Made for Conservation Purposes. Current law allows for increased contribution limits and carry forward periods for contributions of appreciated real property (including partial interests in real property) for conservation purposes. The provision expired on December 31, 2007. The proposal would extend this provision to the end of 2009.

11. Extend the Treatment of RICs as "Qualified Investment Entities." The proposal would extend the inclusion of a RIC within the definition of a "qualified investment entity" under Section 897 of the Code through December 31, 2009, for those situations in which that inclusion expired at the end of 2007.

12. Estate Tax Look-Through for Certain RIC Stock held by Nonresidents. Stock owned and held by a nonresident non-citizen

generally is treated as property within the United States if the stock was issued by a domestic corporation. Although stock issued by a domestic corporation generally is treated as property within the United States, stock of a RIC that was owned by a nonresident non-citizen is not deemed property within the United States in the proportion that, at the end of the quarter of the RIC's taxable year immediately before a decedent's date of death, the assets held by the RIC are debt obligations, deposits, or other property that would be treated as situated outside the United States if held directly by the estate (the "estate tax look-through rule for RIC stock"). This estate tax look-through rule for RIC stock does not apply to estates of decedents dying after December 31, 2007. The proposal permits the estate tax look-through rule for RIC stock to apply to estates of decedents who die before January 1, 2010.

13. R&D Credit. The law provides a research tax credit equal to 20% of the amount by which a taxpayer's qualified research expenses for a taxable year exceed its base amount for that year. The provision expired December 31, 2007. The proposal would extend current law to the end of 2009, with the following changes: 1) repeal the alternative incremental research credit in 2008; 2) increase the alternative simplified credit to 14% for 2008, and 3) increase the alternative simplified credit to 16% for 2009.

14. 15-year Straight-line Cost Recovery for Qualified Leasehold Improvements and Qualified Restaurant Improvements. In AJCA, Congress shortened the cost recovery of certain leasehold improvements and restaurant property from 39 to 15 years for the remainder of 2004 and 2005. The extension of this shortened cost recovery period expired December 31, 2007. The proposal would extend the provision to the end of 2009.

15. Exception under Subpart F for Active Financing Income. The U.S. parent of a foreign subsidiary engaged in a banking, financing, or similar business is eligible for deferral of tax on such sub's earnings if the sub is predominantly engaged in such business and conducts substantial activity with respect to such business in order to qualify for the exceptions. In order to prove this is "active" not passive income, the sub must pass an entity level income test. The provision expires December 31, 2008. The proposal would extend the provision to the end of 2009.

16. New Markets Tax Credit. Current law provides a credit for taxpayers who hold a qualified equity investment on a credit allowance date. The provision expires December 31, 2008. The proposal would extend the provision to the end of 2009.

17. Expensing of "Brownfields" Environmental Remediation Costs. The provision allowing for the expensing of costs associated with cleaning up hazardous sites expired on December 31, 2007. This proposal extends the provision to the end of 2009.

18. Look-through Treatment of Payments Between Related CFCs under the Foreign Personal Holding Company Rules. Present law allows deferral for certain payments (interest, dividends, rents and royalties) from one controlled foreign corporation (CFC) to another CFC. This provision allows U.S. taxpayers to deploy capital from one CFC to another. The provision expires December 31, 2008. The proposal would extend the provision to the end of 2009.

19. Extend and Expand 50% Tax Credit for Certain Expenditures for Maintaining Railroad Tracks. The railroad maintenance credit providing Class II and Class III railroads (short-line railroads) with a tax credit equal to 50% of gross expenditures for maintaining

railroad tracks that they own or lease expired on December 31, 2007. The proposal extends the provision to the end of 2009.

20. Qualified Zone Academy Bonds. QZABs help school districts with low-income populations save on interest costs associated with public financing of school (below the post-secondary level) renovations and repairs. These benefits can be used for other types of school renovations. QZABs cannot be used for new construction but can be used for the following activities: renovating and repairing buildings, investing in equipment and up to date technology, developing challenging curricula, and training quality teachers. QZABs also encourage schools and businesses to cooperate in innovative ways that expand students' learning opportunities and help schools prepare students with the kinds of skills employers, and our nation, need to compete in the global economy. The QZAB provision expired on December 31, 2007. The proposal would extend this provision to the end of 2009.

21. Accelerated Depreciation for Business Property on Indian Reservation. A special depreciation recovery period applies to qualified Indian reservation property placed in service before January 1, 2008. In general, qualified Indian reservation property is property used predominantly in the active conduct of a trade or business within an Indian reservation, which is not used outside the reservation on a regular basis and was not acquired from a related person. This proposal would extend the placed-in-service date for the special depreciation recovery period for qualified Indian reservation property to the end of 2009.

22. Deduction Allowable with Respect to Income Attributable to Domestic Production Activities in Puerto Rico. The provision to allow a Section 199 domestic production activities deduction for

activities in Puerto Rico expired on December 31, 2007. The proposal would extend the provision to the end of 2009.

23. Temporary Increase in Limit on Cover Over of Rum Excise Tax Revenues to Puerto Rico and the Virgin Islands. The present law imposes a $13.50 per proof gallon excise tax on distilled spirits produced in or imported into the United States. The Code provides a payment to Puerto Rico and the Virgin Islands of the excise tax on rum imported into the United States. The payment is limited to $10.50 per proof gallon. This was increased to $13.25 per proof gallon during the period July 1, 1999 through December 31, 2007. The proposal would extend the provision to the end of 2009.

24. Special Expensing Rules for Certain Film and Television Productions. Under current law, a producer can elect to take a single-year deduction of up to $15 million in production costs incurred in the U.S. If the production costs are over $15 million, this deduction does not apply. The maximum deduction is increased to $20 million if the costs are significantly incurred in economically depressed areas. No other depreciation or amortization is allowed for a production for which this deduction is taken. The provision expires December 31, 2008. The proposal would extend the provision to the end of 2009.

25. Enhanced Charitable Deduction for Food Inventory. Currently, only C-Corps may claim an enhanced deduction for donations of food. The enhanced deduction is equal to the lesser of the cost of producing the food item (or basis) plus ½ of the items appreciated value; or twice basis. The provision allowing an enhanced deduction for food donations for Non C Corps (S-Corps, Partnerships, and Sole Props) expired on December 31, 2007. The

proposal extends the enhanced deduction for Non-C Corps to the end of 2009.

26. Indian Employment Credit. The provision allowing a business tax credit for employers of qualified employees that work and live on or near an Indian reservation expired December 31, 2007. The credit is for wages and health insurance costs paid to qualified employees (up to $20,000) in the current year over the amount paid in 1993. Wages for which the work opportunity tax credit is available are not qualified wages for the Indian employment tax credit. The proposal would extend present law to the end of 2009.

27. Basis Adjustment to Stock of S Corp making Charitable Contributions of Property. Prior to the Pension Protection Act of 2006, if an S Corp made a contribution to a charity, shareholders reduced the basis in their stock by their pro rata share of the fair market value of the contribution. The Pension Protection Act provided the amount of a shareholder's basis reduction in the S Corp stock will be equal to the shareholder's pro rata share of the adjusted basis of the contributed property. The provision expired December 31, 2007. The proposal would extend the provision to the end of 2009.

28. Mental Health Parity. The provision stipulating that group health plans that provide medical/surgical and mental health benefits cannot impose limits on mental health that are not imposed on medical/surgical health expired December 31, 2007. There is a $100 excise tax per day for violations. The proposal extends the provision to the end of 2009.

29. 7-Year Recovery Period for Certain Motorsports Racetrack Property. The provision to allow a special 7-year cost recovery period on property used for land improvement and support facilities at motorsports entertainment complexes expired December 31,

2007. Absent this provision, the cost recovery period for these facilities would be 15 years. This proposal extends the provision to the end of 2009.

30. Enhanced Charitable Deduction for Contributions of Book Inventory to Schools. C-Corp received an enhanced charitable deduction for donations of books to schools, public libraries and literacy programs. This provision expired December 31, 2007. The proposal extends to the end of 2009 the enhanced charitable deduction for contributions of book inventory.

31. Modification of Tax Treatment of Certain Payments to Controlling Exempt Organizations. In general, interest, rent, royalties, and annuities paid to a tax –exempt organization from a controlled entity are treated as unrelated business income of tax-exempt organizations. The Pension Protection Act of 2006 provided that if a payment to a tax-exempt organization by a controlled entity is less than fair market value, then the payment is excludable from the tax-exempt organization's unrelated business income. The provision expired December 31, 2007. The proposal would extend the provision to the end of 2009.

32. Extension of WOTC for Hurricane Katrina Employees. The proposal extends for two years the provision that expired in August of 2007 which allowed employers to claim the work opportunity tax credit (WOTC) for hiring employees who were affected by Hurricane Katrina.

33. American Samoa Economic Development Credit. Certain domestic corporations operating in American Samoa were eligible for a possessions tax credit, which offset their U.S. tax liability on income earned in American Samoa from active business operations, sales of assets used in a business, or certain investments in American

Samoa. Further, the credit was held to an economic activity-based limit, measuring the credit against wages, depreciation, and American Samoa income taxes. The provision expired December 31, 2007. The proposal extends the provision to the end of 2009.

34. Mine Rescue Team Training Credit. Present law provides a credit of up to $10,000 for the training of mine rescue team members. The provision expires December 31, 2008. The proposal extends the provision to the end of 2009.

35. Election to Expense Advanced Mine Safety Equipment. Present law provides 50% immediate expensing for qualified underground mine safety equipment (that goes above and beyond current safety equipment requirements), including: (1) communications technology enabling miners to remain in constant contact with an individual above ground; (2) electronic tracking devices that enable an individual above ground to locate miners in the mine at all times; (3) self-contained self-rescue emergency breathing apparatuses carried by the miners and additional oxygen supplies stored in the mine; and (4) mine atmospheric monitoring equipment to measure levels of carbon monoxide, methane, and oxygen in the mine. This provision will encourage mining companies to invest in safety equipment that goes above and beyond current safety equipment requirements. The provision expires December 31, 2008. The proposal extends the provision to the end of 2009.

36. Extension of Credit for Energy Efficient Appliances. Extends for two years (through 2009) the tax credit for production of energy-efficient appliances. Readjusts baseline for the credit.

37. Extension of Non-business Energy Credit. Extends for two years (through 2009) the tax credit for expenditures related to improving energy efficiency of an existing home.

38. Extension of Credit for Residential Energy Efficient Property. Extends through 2009 the 30% credit for purchase of qualified photovoltaic property and solar water heating property used exclusively for purposes other than heating swimming pools and hot tubs. Also extends through 2009 the 30% credit for purchase of qualified fuel cell power plants.

39. Extension of Renewable Electricity and Refined Coal and Indian Coal Credit. Extends through 2009 the period during which certain facilities may be placed in service for purposes of the Section 45 credit. Extends Indian country coal provision for one year.

40. Extension of Business Energy Credit. Extends through 2009 the 30% investment tax credit for solar energy property and qualified fuel cell property, as well as the 10% investment tax credit for microturbines.

41. Extension of Clean Renewable Energy Bonds. Adds $400 million to Clean Renewable Energy Bonds (CREBs) program. Provision is effective for bonds issued after December 31, 2008.

42. Extension of Energy Efficient Commercial Buildings Deduction. Extends through 2009 the tax deduction for energy-efficient commercial buildings.

43. Extension of Energy Efficient New Homes Credit. Extends through 2009 the tax credit to eligible contractors for construction of energy efficient new homes.

44. Permanent Authority for Undercover Operations. The authorization of the IRS to use proceeds it receives from undercover operations to offset necessary expenses incurred in such operations expired on December 31, 2007. Undercover operations are an integral part of efforts of the IRS to detect and prove noncompliance. The

temporary status of this provision creates uncertainty as the IRS plans its undercover efforts from year to year. The proposal permanently authorizes the IRS to return funds collected through undercover operations back into the IRS undercover program.

45. Permanent Disclosures for Combined Employment Tax Reporting of Certain Tax Return Information. The proposal makes permanent the authority of the IRS to disclose employment tax information to the states, which expired on December 31, 2007.

46. Extension of Disclosures of Certain Tax Return Information Relating to Terrorist Activities. This proposal extends the IRS's authority of the IRS to make disclosures relating to terrorist activities to the end of 2009.

47. Permanent Extension of Disclosure Authority to the Department of Veterans Affairs. Current law allows the Social Security Administration to disclose tax return information regarding net earnings for purposes of verifying reporting of net earnings for purposes of verifying eligibility for needs-based pensions, dependency and indemnity compensation to parents of a deceased veteran, hospice care and certain unemployment compensation. This provision expired on September 30, 2008. The proposal would make the present law permanent.

II. MICHIGAN

A. Michigan Business Tax. Senate Bill 94 of 2007, the Michigan Business Tax (MBT) took effect on January 1, 2008, and replaced the recently repealed Single Business Tax (SBT).

1. The Tax.

- Business income taxed at a rate of 4.95%
- Margins tax on sales minus purchases of tangible property at a rate of 0.8%
- Banks pay alternate tax capital stock (net worth at a rate of 0.235%)
- Insurance tax rate 1.25% of gross direct premiums (exceptions and credits apply)

2. Credits for Investing in Michigan.

- Investment tax credit for purchase of capital
- Compensation credit for jobs created or retained
- Research and development credit
- Investment and Compensation credits up to 65%, can increase to 75% with R&D

3. Small Business Features.

- $350,000 (minus cost of tangible goods) filing threshold maintained
- Phase in of liability eliminates "cliff" affect that imposes full liability at $1 over threshold
- Alternate profits tax lowered to 1.8%
- Eligibility for small business treatment expanded from $10 million to $20 million of gross receipts
- Compensation caps (including benefits) increased to $180,000
- Start up business exemption

4. Tax Reductions over Current SBT.

- 65% on average for manufacturing
- 23% on average for commercial property
- 23% for telephone property
- 10% for natural gas pipelines

5. Summary. Summaries of Michigan's new business tax system can be found on the Michigan Legislature's web site www.legislature.mi.gov or

the State of Michigan's web site for taxes http://michigan.gov/taxes/, including:

- SB 94/PA 36— state gross receipts tax on businesses
- HB 4369/PA 37— exemption for certain personal property from certain school operating mills
- HB 4370/PA 38—exempts certain industrial and commercial personal property from the state education tax
- HB 4371/PA 39—revises calculation of tax levied on plant rehabilitation
- HB 4372/PA 40—exempts commercial and industrial personal property from the property tax.

B. Conditional Rescission of Principal Residence Exemption. Legislation enacted in 2008 amended Mich. Comp. Laws Ann. § 211.7cc to enable a person who has established a new principal residence in Michigan to retain a Principal Residence Exemption (PRE) on property previously exempt as the owner's principal residence (if the property is not occupied, is for sale, is not leased and is not used for any business or commercial purpose) by submitting a Conditional Rescission of Principal Residence Exemption Form 4640. The deadline for the form submission was May 1, 2008, for the 2008 tax year, but any homeowner who missed the May 1 deadline for the 2008 tax year may now file an appeal with their community's July or December 2008 Board of Review. The conditional rescission allows an owner to receive a PRE on his or her property and on previously exempted property simultaneously if certain criteria are met. An owner may receive the PRE on the previous principal residence for up to three years if that property is not occupied, is for sale, is not leased, and is not used for any business or commercial purpose.

C. L. 2008, H5898 (P.A. 270). Effective for tax years starting on or after 01/01/2009, L. 2008, H5898 (P.A. 270) allows a taxpayer that has entered into an agreement with the Michigan Economic Growth Authority that provides that the taxpayer will create at least 700 qualified new jobs; make at least $50 million in a qualified capital investment ($25 million of which must be made before a certificate is issued); and construct and operate in Michigan a new facility for development and manufacture of photovoltaic energy, photovoltaic systems, or other photovoltaic technology to claim a credit against the Michigan Business Tax equal to 50% of the capital investments made by the taxpayer in that new facility during the tax year. The credit must be taken by the taxpayer in equal installments over two years starting with the tax year in which the certification was issued by the Authority. If in any of those years the credit exceeds the taxpayer's or assignee's tax liability for the year, the excess must be refunded. The Authority cannot enter into an agreement with a taxpayer after November 1, 2008 and the total amounts of the credit for all tax years cannot exceed $25 million. The taxpayer may assign all or part of the credit. If a taxpayer or assignee that claims the credit later fails to meet the requirements of the credit or any conditions established by the agreement with the Authority, may, as determined by the Authority, have its credit reduced or terminated, or have a percentage of the credit amount previously claimed added back to the taxpayer's tax liability in the year that the taxpayer or assignee fails to comply.

III. ESTATE PLANNING

A. Federal Estate Repeal.

1. Federal Estate Tax Update 2002-2010. The Economic Growth and Tax Relief Reconciliation Act of 2001 includes the repeal of federal estate taxes for people dying after December 31, 2009. Between January 1, 2002 and December 31, 2009, the current federal estate tax will gradually decrease as shown in the following table.

Year	Highest Estate and Gift Tax Rate	Amount Exempt from Estate Tax
2002	50%	$1 million
2003	49%	1 million
2004	48%	1.5 million
2005	47%	1.5 million
2006	46%	2 million
2007	45%	2 million
2008	45%	2 million
2009	45%	$.5 million
2010	Top Individual Rate (for gift tax only)	Unlimited - Taxes Repealed

It is very important to be aware that this repeal is temporary; the entire law "sunsets" (expires) after December 31, 2010. This means that the provisions of this 2001 Tax Act will no longer be effective on January 1, 2011 and the tax structure as it existed in 2001 will take effect again (in 2011, federal estate tax will be assessed on property in excess of $1 million with a maximum tax rate of 55%.)

2. Federal Gift Tax. Congress did NOT repeal the federal gift tax, although it raised the lifetime gift tax exemption (the amount that may be passed without gift tax) to $1 million, effective in 2002. This means that a person could make a total of $1 million of gifts over his/her lifetime before owing any federal gift tax. Gifts of more than $1 million WILL be taxed, regardless of the exemption for transfers at death. Beginning in 2010, the gift tax rate will equal the highest individual income tax rate (currently scheduled to be 35% in 2010).

3. Basis of Inherited Property. "Step-up in basis" will continue until December 31, 2009. The "basis" of a piece of property is generally the purchase price of that property and is used to calculate taxable gain when property is sold. The greater the increase in value of property, the greater the taxable gain when sold. A "step-up in

basis" means that the basis of inherited property increases to the value of the property on the date of death.

For the year 2010, "step-up" will be replaced by "carry-over basis" rules. Carry-over basis generally means the basis of inherited property remains the same as it was for the deceased owner; which potentially increases the amount of gain (and tax) when the property is sold. When property is inherited, the heir can choose to take a "step-up" in basis for only $1.3 million of the property. For any amount inherited over $1.3 million, the heir's basis will be the smaller of the deceased owner's basis or the date-of-death market value. The basis of property passing to a surviving spouse can be increased by an additional $3 million. Basis of property given to the decedent by someone other than his/her spouse within 3 years of death cannot be increased. Remember, in 2011, step-up in basis generally resumes as it existed prior to this Act, because all provisions of this tax act expire after December 31, 2010.

4. State Death Tax. Currently, there is a credit against federal estate taxes for death taxes paid to a state. This state death tax credit will be reduced from current levels as follows:

2002 - reduced by 25%
2003 - reduced by 50%
2004 - reduced by 75%
2005 - Completely Repealed

Beginning January 1, 2005, a deduction will be allowed for death taxes actually paid to any state or to the District of Columbia.

B. Provisions regarding tax character of distributions to charity must have a non-tax economic effect. The Treasury Department has issued proposed regulations (NPRM REG-101258-08, June 18, 2008) under Internal Revenue Code Sections 642(c) and 643 regarding the tax consequences of an ordering provision in a trust, will or local law that attempts to determine the tax character of amounts paid by a trust or estate to a charitable beneficiary. An estate or trust receives an unlimited income tax deduction under IRC Section 642(c) for charitable contributions made pursuant to the terms of the governing instrument. When determining whether an amount paid to a charitable beneficiary includes particular items of income not included in gross income, such as tax-exempt income, Treasury Regulations Sections 1.642(c)-3(b)(2) and 1.643(a)-5(b) provide that the governing instrument's provisions will control if they specifically state the source from which amounts are to be paid, for purposes of the charitable deduction and distributable net income purposes, respectively. Otherwise, the amount distributed is deemed to consist of a proportionate amount of each class of the estate's or trust's items of income.

C. Automatic Extensions for Trust, Estate and Partnership Returns are Reduced to Five Months. The deadline for their filings has effectively been moved up to September 15. This change is brought to you by the final and temporary regulations (T.D. 9407; IR-2008-84, NPRM REG-115457-08) issued by the IRS on July 1, 2008. These regulations relate to obtaining automatic extensions of time to file returns. The final regulations adopt temporary regulations previously issued in T.D. 9229 without significant change. That means the automatic extensions for trust, estate and partnership returns are now for five months. The temporary regulations reduce from six to five months the automatic extension period for estates and trusts filing Form 1041 (U.S. Income Tax Return for Estates and Trusts) and partnerships filing Form 1065 (U.S. Partnership Return of Income) or Form 8804 (Annual Return for Partnership Withholding Tax). As a result, an estate or trust will need to file Form 1041, and a partnership with a calendar tax year will need to file Form 1065, by September 15 rather than October 15. This change will enable individual taxpayers to obtain the Schedule K-1 information necessary to complete their personal tax returns by their October 15, six-month extended due date. This change is effective for returns due on or after Jan. 1, 2009. The six-month extension period will continue to apply to returns required to be filed before Jan. 1, 2009.

D. IRS Claims Restricted Management Accounts are not Entitled To Valuation Discounts. Although use of restricted management accounts (RMAs) is far from widespread, the IRS, with a recent revenue ruling, seems to have declared its intention to shut them down so it does not have to fight valuation discounts on two fronts: RMAs and family limited partnerships. But we will see how successful the Service will be. A revenue ruling does not have the force of law and its conclusions could be disputed in court. In Revenue Ruling 2008-35, IRB 2008-29 (decided July 21, 2008), the IRS held that an interest in an RMA will be valued for transfer tax purposes without any reduction or discount for the restrictions imposed by the RMA agreement. An RMA is essentially an irrevocable, long-term asset management contract between an investor and bank (most other investment managers cannot enter into irrevocable term agreements). The bank manages the funds for, say, five years, after which the investor can renew the agreement or take his money back. The rationale for the contract was, according to the revenue ruling, to "maximize the portfolio's long term performance without the risk of withdrawal of assets from the RMA before the expiration of the selected term of the RMA." In exchange, the bank accepted a reduced investment management fee, because it was guaranteed a fee over the fixed term of the RMA. The taxpayer funded the RMA with marketable securities and cash. The taxpayer, with the bank's consent, could transfer all or any part of the RMA, but only to a permitted transferee, who was defined as a spouse, parent or descendant, or to an estate or trust benefiting a permitted transferee. The following year, the taxpayer assigned a one-sixth interest to his child, and in accordance with the RMA agreement, the bank established a new RMA for the child subject to the same terms and transferred over one-sixth of the assets. In Year 3, the taxpayer extended the term of the RMA. The taxpayer died in Year 4. The ruling holds that "the fair market value of an interest in an RMA for gift and estate tax purposes is determined based on the fair market value of the assets held in the RMA without any reduction or discount to reflect restrictions imposed by the RMA agreement on the transfer of any part or all of the RMA or on the use of the assets held in the RMA." As a result, the gift of the interest in the RMA was equal to the full fair market value of the assets transferred into the child's separate RMA. Also, the amount included in the taxpayer estate for estate tax purposes was the full fair market value of the assets in the RMA at his death.

IV. EMPLOYEE BENEFITS

A. Section 409A. The IRS has issued final regulations under Section 409A of the Internal Revenue Code, which generally states that if certain requirements regarding the timing of deferred compensation are not met, then all deferred amounts are immediately included in income. In addition to regular income tax, Section 409A imposes an additional 20%, plus interest on the deferred compensation. The requirements of Section 409A have been in effect since the beginning of 2005, but the IRS postponed the deadline for full compliance until January 1, 2008, when the final regulations took effect. The IRS then issued Notice 2007-78, extending to December 31, 2008, the deadline to amend or adopt written documents for nonqualified deferred compensation ("NQDC") plans subject to Section 409A.

1. Identifying Plans that are Subject to Section 409A. In order to comply with Section 409A, an employer must first examine all of its compensation plans to determine whether they involve deferred compensation. A plan provides for deferral of compensation if the employee has a legally binding right to compensation that is payable in a later tax year. Even if the legally binding right is

subject to a later condition, such as the requirement that the employee continue to work for the employer until a future date, the compensation is still considered deferred compensation. Certain plans enjoy an exemption from the Section 409A requirements. Qualified retirement plans, tax-deferred annuities, simplified employee pensions (SEPs), and SIMPLE retirement accounts are not considered NQDC plans. Section 409A also does not apply to some welfare benefit plans, such as bona fide vacation leave, sick leave, compensatory time, disability pay, and death benefit plans. There is also an exception for short-term deferrals. Under this rule, there is no deferral of compensation if the employee receives the compensation by 2-1/2 months after the end of the tax year of the employer or employee, whichever is later, in which the amount is no longer subject to a substantial risk of forfeiture. For example, if a calendar-year employer awards a bonus on November 1, there is no deferral of compensation if the bonus is paid or made available to the employee by the next March 15. Nonstatutory stock options and stock appreciation rights (SARs) on employer stock don't provide for deferral of compensation if the option or SAR is not in the money on the date of grant, and there is no other feature for deferral of compensation. Which stock qualifies as stock of the employer for this purpose and how that stock is valued are complex questions.

2. How to Comply with Section 409A. If it is determined that Section 409A applies to a plan, the next step is to make sure that the plan complies with the Section 409A requirements. There are four general requirements that relate to: (1) the initial deferral election, (2) the timing of payments, (3) acceleration of payments, and (4) later deferral elections. Each of these requirements must be spelled out in the plan document, and the plan must be operated in accordance with them.

a. Initial Deferral Elections. In general, an employee must make the initial election to defer compensation before the year in which the services are performed. In an employee's first year of eligibility, he may make a deferral election in the first 30 days of participation, but the election may apply only to compensation earned after the election was made. An election to defer performance-based compensation that is based on services performed over 12 months or more must be made no later than six months before the end of the performance period.

b. Timing of Payments. Payments under an NQDC plan must be made at a fixed date, under a fixed schedule, or upon any of these five events: separation from service, death, disability, change in ownership or control of the corporation, or unforeseeable emergency. If the timing of payment is based on a specified event, the plan must designate an objectively determinable date or year after the event on which payment is to be made. This rule prohibits "haircut" provisions, under which a participant may take payments at any time, subject to a reduction in amount.

c. Anti-acceleration Rule. Payments of deferred compensation generally may not be accelerated. The IRS has provided exceptions to this rule, such as for payments necessary to comply with a domestic relations order, payments necessary to comply with conflict-of-interest rules, or certain payments upon plan terminations. IRS may allow other exceptions.

d. Later Deferral Elections. If a NQDC plan permits an employee to elect to delay or change the form of a payment, the following conditions must be met:

i. The election may not take effect until at least 12 months after the date on which it was made;

ii. If the election relates to a payment that is not on account of death, disability or unforeseeable emergency, the first payment for which the election is made must be deferred for at least five years; and

iii. Any election related to a payment at a specified time or under a fixed schedule may not be made less than 12 months before the date of the first scheduled payment.

3. Deadline for Amending. Section 409A generally applies for: (1) amounts deferred in tax years beginning after 2004; and (2) amounts deferred in tax years beginning before 2005 if the NQDC plan is materially modified after October 3, 2004. The IRS has given taxpayers until the end of 2008 to amend plan documents to comply with Section 409A and the final regulations. However, beginning on January 1, 2008, plans must be operated in compliance with the final regulations and must, at a minimum, include the time and form of payment in writing.

B. Medicare Part D Deadlines for Calendar Year Plans. All group health plans that offer prescription drug coverage to Medicare-eligible employees (under either an active plan or a retiree plan) must provide the annual creditable coverage disclosure notice to Medicare-eligible participants and dependents, no later than Nov. 15, 2008. The notice has been updated recently and can be accessed at http://www.cms.hhs.gov/CreditableCoverage/09_ccafterJune15.asp. Also, group health plan sponsors with a calendar year plan year must apply for the Medicare Part D retiree drug subsidy no later than 90 days prior to the beginning of the plan year, or October 2, 2008. A 30-day application extension is available if the extension request is filed by October 2, 2008. The subsidy application and extension should be submitted to the Centers for Medicare and Medicaid Services (CMS) through the Retiree Drug Subsidy Center Web site, http://www.rds.cms.hhs.gov.

C. Form 5500 Filing Deadline for Calendar Year Plans with Extensions. If a plan administrator filed a Form 5558 for a calendar year plan on or before July 31, 2008, the plan's Form 5500 filing deadline is extended to October 15, 2008. Additionally, if the plan sponsor extended its corporate federal income tax return date, the plan may be eligible for an automatic extension until September 15, 2008, if certain criteria are satisfied. When preparing Form 5500, plan sponsors may become aware of amendments that were not adopted timely. Certain late amendments can be adopted retroactively under the Voluntary Correction Program of the Internal Revenue Service's Employee Plans Compliance Resolution System. An abbreviated correction application permits certain plan sponsors to adopt certain late amendments for the nominal fee of $375 for each year in which failure to adopt occurred.

D. Second Circuit Holds Cash Balance Plan is Not Age Discriminatory. The Second Circuit joined the Seventh, Third and Sixth Circuits in holding in two cases heard in tandem that the crediting mechanism of cash balance plans is not inherently age discriminatory. Hirt v. Equitable Retirement Plan for Employers, Managers and Agents, 2008 WL 2669346 (2d Cir. 2008); Bryerton v. Verizon Communications, Inc., 2008 WL 2669346 (2d Cir. 2008). The Second Circuit adopted the position held by the Seventh, Third and Sixth Circuits and ruled that the phrase "rate of benefit accrual" in ERISA section 204(b)(1)(H)(i) refers to the employer's contributions to the plan and that any difference in a participant's benefits relating to time and interest compounding does not violate ERISA.

E. IRS Issues Final Regulations on Mortality Assumptions. The IRS issued final regulations containing the mortality assumptions for determining the funding target for single employer defined benefit plans and determining the current liability of multiemployer defined benefit plans. Treas. Reg. § 1.430(b)(3) 1; Treas. Reg. § 1.431(c)(6) 1. The final regulations are very similar to the proposed regulations issued on May 29, 2007. The mortality tables are based on the RP 2000 Mortality Tables, and include both static and generational tables. The mortality tables are also gender-specific and include annuitant and nonannuitant tables due to the different life expectancies for annuitants and nonannuitants. The final regulations also allow the use of substitute mortality tables, subject to the approval of the IRS. Treas. Reg. § 1.430(h)(3)-2. The final regulations apply to plan years beginning on or after Jan. 1, 2008, while the regulations relating to the use of substitute mortality tables apply to plan years beginning on or after Jan. 1, 2009. Only single-employer defined benefit plans can use substitute mortality tables. Single employer plans that wish to use substitute mortality tables must request approval to use their proposed substitute mortality tables at least seven months prior to the beginning of the plan year for which they are proposing to use the substitute tables.

F. Former Participants Have Standing to Sue. The First and Fourth Circuits recently held that former defined contribution plan participants had standing to sue under ERISA section 502(a)(2), despite not having a current account balance. Evans v. Akers, 2008 WL 2780607 (1st Cir. 2008); In re Mutual Funds Investment Litigation, 529 F.3d 207 (4th Cir. 2008). In Evans, the plaintiffs alleged that the fiduciaries of the W.R. Grace & Co. Savings and Investment Plan breached their fiduciary duties when they imprudently kept the Grace company stock fund as an investment option under the plan. The plaintiffs maintained that the breach of fiduciary duty reduced the values of their accounts. The plaintiffs in Evans all took lump sum distributions from the plan prior to filing the suit alleging a fiduciary breach under ERISA section 502(a)(2). Similarly, the plaintiffs in the Mutual Funds Investment Litigation alleged a breach of fiduciary duty based on offering as an investment option under the plan mutual funds which were alleged to be involved in market timing, thereby reducing the value of the plaintiffs' accounts. In this case, the plaintiffs had also cashed out their accounts prior to filing their lawsuit. The district courts in both cases held that the plaintiffs did not have standing to bring their claims, on the basis that they were not "participants" because they were seeking monetary damages and not additional plan benefits, as required under ERISA section 409. Both appellate courts concluded that the plaintiffs were participants as defined under ERISA section 3(7) because defined contribution plan participants are entitled to the entire value of their accounts, which includes the lost amounts due to the alleged fiduciary breaches. A "participant" under ERISA can be a "former employee ... who is or may become eligible to receive a benefit." The courts reasoned that under the analysis of Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, the plaintiffs are participants because they have a "colorable claim that [they] will prevail in a suit for benefits" because they are entitled to the complete value of their accounts. In further support of their holdings, each court cited the LaRue v. DeWolff, Boberg & Assocs., Inc., 128 S. Ct. 1020, 1023 n.1 (2008) for the proposition that a cashed-out employee is able to sue his former employer for a fiduciary breach that caused a loss to his or her individual plan account. The court dismissed various arguments made by the plans, including the argument that a loss due to a breach of fiduciary duty was not redressable. The courts held that this type of injury is redressable because the recovery would be allocated to each of the injured accounts. The First Circuit also held that the damages were not too speculative because they could be estimated by experts using a prudently invested portfolio.

G. SEC and DOL Agree to Share Information. On July 29, 2008 the DOL and the U.S. Securities and Exchange Commission signed a memorandum of understanding concerning the cooperation between the two agencies.

Both agencies acknowledged that they have matters of mutual interest in retirements and investments. Under the memorandum, the agencies agreed to meet regularly to discuss examination results, enforcements cases, and other matters of interest. Each agency's regional office will have a designated contact person to facilitate inter-agency communication and the agencies will periodically cross-train to learn more about the other agency's roles. The SEC granted the DOL standing access to nonpublic, relevant examination results, and the DOL agreed to keep this information confidential. The DOL and SEC also agreed to share nonpublic enforcement information regarding investment advisers and other firms.

H. First Fines Imposed Under HIPAA. The Department of Health and Human Services (HHS), the governmental agency responsible for enforcing the Health Insurance Portability & Accountability Act of 1996 (HIPAA), entered into a corrective action plan with Providence Health & Services (Providence), an integrated health system, and fined Providence $100,000 for several violations of the HIPAA Security Rules. This is the first instance of HHS imposing a fine for a HIPAA violation. HIPAA requires that covered entities maintain policies and procedures to ensure the safety of protected health information (PHI). In the Providence case, the unencrypted electronic PHI of 386,000 patients contained on laptops and electronic storage devices was compromised because an employee's car containing the information was broken into and the items containing the PHI were stolen. HHS determined that the breach was caused by Providence's failure to implement security policies and procedures regarding the security of PHI. An HHS representative stated that compliance with the HIPAA Security Rules requires more than just implementing policies and procedures, it requires security staffing, training and adequate physical safeguards. HHS's actions should alert covered entities to review their current compliance with the HIPAA Security Rules, including analyzing their policies and procedures and monitoring efforts.

I. ESOP Dividends – New Tax Reporting Rules. For a C corporation, a deduction is allowed for any Internal Revenue Code (Code) Section 404(k) dividend paid in cash by the corporation during the taxable year with respect to applicable employer securities held by an employee stock ownership plan (ESOP) maintained by the corporation or by a related corporation. A 404(k) dividend generally is any dividend that, in accordance with the provisions of the ESOP, is paid directly to ESOP participants or their beneficiaries; is paid to the ESOP and is distributed in cash to plan participants or their beneficiaries within 90 days after the close of the plan year in which paid; or is, at the election of plan participants or their beneficiaries, paid to such participants or their beneficiaries or paid to the ESOP and distributed in cash to such participants or their beneficiaries within 90 days after the close of the plan year in which paid. Section 404(k) dividends are not subject to the 10% additional tax on early plan distributions, are not eligible rollover distributions, are not subject to withholding under Code Section 3405, and are not taken into account in determining if Code Section 401(a)(9) required minimum distributions have been made. Distributions of 404(k) dividends from an ESOP that are made in 2009 or later years will have to be reported on an IRS Form 1099-R that does not report any other distributions. Accordingly, if there are other distributions from the ESOP beginning in 2009 that are not 404(k) dividends, they must be reported on a separate Form 1099-R. It is anticipated that the instructions will require a special code in Box 7 of Form 1099-R to indicate the special tax treatment and rollover restrictions applicable to 404(k) dividends. Payments of 404(k) dividends made directly from the corporation to the plan participants or their beneficiaries are reported on Form 1099-DIV. (IRS Announcement 2008-56)

J. Mere Posting of SPD on Intranet Does Not Ensure Actual Receipt. Many employers today seek to reduce the cost of printing and delivering summary plan descriptions (SPDs) by posting the SPDs on employer intranet sites or by other electronic means. A recent case reminds us, however, that there are specific requirements that need to be followed if an employer wishes to furnish SPDs and other forms of ERISA disclosures electronically. To deliver SPDs and other disclosures electronically, the administrator, among other things, must take appropriate measures reasonably calculated to ensure that the electronic method of delivery results in actual receipt of the SPD. In a case heard by the Ninth Circuit Court of Appeals, the court found that the administrator failed to show it properly furnished an employee with a copy of the employers disability plan SPD because the administrator "had submitted nothing on the record to suggest that the mere placement of an updated SPD on [the employer's] intranet site could ensure [the employee] would actually receive the information." As a result, for purposes of defending a claim for disability benefits, the administrator could not rely on language in the electronically posted SPD that unambiguously conferred on the administrator discretionary authority to determine eligibility for benefits and to construe the terms of the plan. (Gertjejansen v. Kemper Ins. Co., 9th Cir. 2008)

K. Trilogy of IRS Guidance Regarding Health Savings Accounts. Recent guidance issued by the IRS in the form of Notices 2008-51, 2008-52, and 2008-59, provides important guidance on health savings accounts (HSAs), including guidance on:

- tax-free transfers from IRAs and Roth IRAs to HSAs,
- contribution limits for employees who become HSA-eligible mid-year,
- health coverage an otherwise HSA eligible individual can have without losing his or her HSA eligible status, and
- circumstances under which employers can recoup mistaken HSA contributions.

1. Background. An HSA is a tax-exempt custodial account established for the purposes of paying qualified medical expenses. Employers,

employees, and others may contribute, tax-free, to an individual's HSA within specified limits. For 2009, the annual limits are $3,000 for individuals enrolled in single coverage and $5,950 for individuals enrolled in family coverage. Distributions are tax-free if used to pay qualified health care expenses. An employee can establish an HSA if he or she is an HSA eligible individual. An individual is HSA eligible if he or she is covered by a qualified high deductible health plan (HDHP), has no other health plan coverage (with the exception of certain plans providing certain types of limited coverage), is not enrolled in Medicare, and may not be claimed as a dependent on another person's tax return. An HDHP is a health plan that satisfies certain requirements with respect to deductibles and out-of-pocket expenses. For 2009, the minimum deductible may not be less than $1,150 for single coverage and $2,300 for family coverage. Notice 2008-51. HSA eligible individuals are entitled to make a one-time tax-free transfer from their IRAs or Roth IRAs to their HSAs.

2. Notice 2008-51. In this notice, the IRS provides detailed guidance concerning these types of transfers, referred to as "qualified funding distributions." A qualified funding distribution may not exceed the maximum HSA contribution for the year reduced by any other contributions to the individual's HSA for that year. A qualified funding distribution is neither includible in income nor subject to the 10% penalty tax for early IRA withdrawals, provided the individual remains HSA eligible for each of the 12 months following the month in which the qualified funding distribution is made. For example, if an individual receives a qualified funding distribution on February 10, 2009, the individual must remain HSA eligible through February 2010. The notice confirms that employees who cease to be HSA eligible during this period are required to pay tax on the qualified funding distribution in the year they cease to be eligible. The 10% penalty tax may also apply. Employers who maintain HDHPs are

not required to ensure that these transfers qualify; compliance is the responsibility of the employee. However, employers who wish to assist employees in properly structuring these transfers will want to consult Notice 2008-51.

3. Notice 2008-52. In this notice, the IRS explains the contribution limits for employees who become HSA eligible mid-year. An individual's maximum HSA contribution for a year is the greater of the following two amounts:

- Pro-rated Contribution Limit. One-twelfth of the annual limit multiplied by the number of months for which an individual is HSA eligible.
- Full Annual Contribution Limit. The maximum annual HSA contribution based on the individual's HDHP coverage self only or family, on the first day of the last month of the individual's taxable year (December 1 in the case of calendar year taxpayers).

If a calendar year taxpayer is not HSA eligible on December 1, the individual's maximum HSA contribution for the year is the pro-rated contribution limit described in the first bullet above. Note that using the full annual contribution limit will not be tax-effective unless the individual maintains his or her HSA eligibility for each month of the following year. An exception applies in the case of an individual who ceases to be HSA eligible because of disability or death.

The following examples illustrate these rules:

<u>Example 1</u> Individual A, age 53, enrolls in family HDHP coverage on December 1, 2008 and is otherwise an eligible individual on that date. A is not an eligible individual in any other month in 2008. A's full contribution limit for 2008 is $5,800. The pro-rated contribution limit is $483 (1/12 x $5,800). A's annual contribution limit for 2008 is $5,800, the greater of $5,800 or $483.

Example 2 Same facts as Example 1, except that A contributes $5,800 to his HSA on December 1, 2008 and ceases to be eligible in June 2009. In 2009, A must include in gross income $5,317, the amount contributed to the HSA for 2008 minus the pro-rated contribution limit ($5,800 - $483). In addition, the 10% additional tax ($532) applies to the amount included in gross income because A is not 59 ½.

Example 3 Individual E, age 35, has self-only HDHP coverage and is eligible for the months of May, June, and July 2008. The full annual contribution limit does not apply to E for 2008 because E is not an eligible individual on December 1, 2008. E's contribution limit for 2008 is $725 (3/12 x $2,900).

4. Notice 2008-59. In this notice, the IRS provides guidance on a number of matters, including guidance addressing the kinds of health coverage an otherwise HSA eligible individual can have without losing his or her HSA eligible status and the circumstances under which employers can recoup mistaken HSA contributions.

5. Other Health Coverage. As noted, an individual is not HSA eligible if, in addition to HDHP coverage, he or she has certain other kinds of health coverage. The notice confirms that an employee may be covered by a limited purpose or post-deductible HRA that pays or reimburses the employee's share of the premium for the employer's HDHP; it is not necessary for the HDHP deductible to be exhausted before premiums can be paid or reimbursed.

6. Post-Deductible HRAs and Health FSAs. A post-deductible HRA or health FSA is health care coverage that does not render an otherwise HSA eligible employee ineligible. The post-deductible HRA or FSA pays or reimburses expenses incurred by employees or dependents for qualifying expenses that exceed the minimum

annual deductible (for 2009, $1,150 for single coverage, $2,300 for family coverage). In Notice 2008-59, the IRS clarifies that only medical expenses that would have been covered by the HDHP count toward satisfaction of the deductible. In addition, the notice makes it clear that a post-deductible HRA or FSA may reimburse eligible expenses only if the expense is incurred after the deductible has been satisfied.

7. Erroneous HSA Contributions. Notice 2008-59 describes the circumstances under which employers may recoup erroneous contributions to an employee's HSA. The IRS says that employers may recoup contributions to the HSA of an employee who was never HSA eligible. In addition, an employer may recoup its contributions to an employee's HSA if, due to an error, the aggregate amount contributed is in excess of the maximum annual contribution. In both instances, any amount not recouped by the end of the year in which the contributions were made must be included as wages on the employee's W-2 for that year. The notice points out that an employer generally may not recoup amounts from an HSA except under the circumstances described above. For example, the notice indicates that an employer may not recoup contributions to the HSA of an HSA eligible employee made after an employee ceases to be HSA eligible.

L. Service by Director as Interim CEO Results in Loss of Tax Deduction for Corporation. Code Section 162(m) generally provides that a publicly traded company may not deduct compensation with respect to "covered employees" to the extent that the compensation exceeds $1 million, unless the compensation meets a permitted exception. Performance based compensation is one of the permitted exceptions. To qualify for the performance based compensation exception, performance goals must be determined by a compensation committee that is comprised solely of two or more outside directors. At issue in Rev. Rul. 2008-32 is whether a director who served as an interim CEO following the current CEO's resignation on January 7 of a particular year qualifies as an outside director. In response to the resignation, a member of the board of directors was appointed as interim CEO and served in such a capacity through December 11 of that year, a little over 11 months. In January of the following year, the director joined the compensation committee. The IRS ruled that the director was a former officer of the corporation and therefore did not qualify as an outside director. Applying the regulations to this specific situation, the IRS held that the director served as the interim CEO for an unspecified period of time and therefore did not fall within the exception under the regulations for employees serving as an officer for a special and single transaction. Because the compensation committee no longer consisted solely of outside directors, the committee would not be able to set performance goals that would qualify for the exception to Code Section 162(m).

M. IRS Proposes Regulations Regarding "Greater of" Formulas. The IRS provided a limited period of relief in Rev. Rul. 2008-7 regarding the application of the benefit accrual rules under Code Section 411(b)(1) with respect to plans that provided for a "greater of" benefit formula. This relief was very important to certain cash balance conversions where a greater of formula might apply as a means to transition from a traditional benefit formula to a cash balance formula. Generally, the accrual rules are intended to prevent "back loading" that would occur when a defined benefit plan provides a faster rate of benefit accrual later in the participant's period of service. The relief granted under Rev. Rul. 2008-7 was limited in that it applied to plan years beginning before January 1, 2009. The IRS has proposed regulations that would be effective for plan years beginning on or after January 1, 2009 by allowing plans with multiple benefit formulas, such as "greater of" formulas, to test each formula separately under the 133-1/3% accrual rule. Under the 133-1/3%

accrual rule, a participant's accrual in a year may not exceed 133-1/3% of his or her accrual in any prior year. Under the proposed regulations, all benefit formulas would have to satisfy the 133-1/3% accrual method and the formulas tested separately must be calculated under different benefit approaches. For example, the benefit formulas could be a final pay formula and a career average formula. (REG-100464-08)

N. No FICA Tax Refund On Benefits Never Received. The IRS has advised that retired employees are not entitled to a refund of Federal Insurance Contributions Act (FICA) taxes paid at retirement on the value of their nonqualified deferred compensation benefits, even though the retirees will never receive the full value of their promised benefits. In accordance with Code Section 3121(v)(2), the retirees in question paid FICA tax on the entire accrued value of their benefits in the nonqualified deferred compensation arrangements when those benefits became reasonably ascertainable on their retirement. Because the benefits were granted under unfunded, nonqualified arrangements, the amounts in question were subject to the claims of creditors in the event of the employer's insolvency. Unfortunately for the retirees, their former employers filed for Chapter 11 bankruptcy and terminated their plans, resulting in the cessation of benefit payments. Faced with the loss of their benefits, many former employees filed claims for partial refund of their FICA taxes. The IRS determined that the employees were not entitled to a refund because the FICA tax was correctly imposed at retirement on the amounts deferred under the plans. In the IRS's view, the fact that the employees would never receive the full amount deferred because of their employer's bankruptcy does not give them the right to receive a refund of FICA taxes paid on those benefits that were promised but never received. In a related finding, the IRS also concluded that the three-year statute of limitations for purposes of submitting refund claims for the employee's share of FICA taxes paid on amounts deferred under nonqualified deferred compensation plans begins on April 15 of the year following the year in which the employee retired and the employer filed the FICA tax return and remitted the appropriate taxes to the IRS. After this three-year limitation period has expired, no adjustment or refund is possible. (Chief Counsel Advice 200823001)

V. M&A

A. SFAS 141. In December 2007, the Financial Accounting Standards Board (FASB) adopted a new accounting standard governing M&A transactions. For calendar-year companies, the new standard will apply to all acquisitions, beginning January 1, 2009. Companies and their deal lawyers will need to become familiar with these new standards, as they will likely have a substantial impact on transaction planning. Under the current standard, called Statement of Financial Accounting Standards 141 (SFAS 141), all acquisition transactions are accounted for using the "purchase method." The total consideration paid in an acquisition is determined and then allocated to identifiable assets acquired and liabilities assumed, in each case at their value as of the date of closing. Any excess of the purchase price over the value of the assets and liabilities is recorded as goodwill. Revised Statement of Financial Accounting Standards 141 (SFAS 141R) modifies the conceptual framework for accounting for business combination transactions. The purchase method uses a "cost allocation" approach, in which the total cost of an acquisition is determined and then allocated to the specific assets and liabilities acquired. Acquisition accounting under SFAS 141R adopts a "fair value" approach. The principal inquiry is to determine the value of the assets and liabilities to the business as of the date of the acquisition and to record those values. The clearest example of the impact of this change is in the treatment of acquisition expenses, such as investment banking and legal fees. Under prior SFAS 141, these costs are capitalized and allocated to the assets and liabilities acquired. Under the new rules, these transaction costs are recorded as an expense as of the acquisition date. Other significant changes to M&A accounting under the new standard include:

- Earnouts: The fair value of contingent consideration must be determined and recorded as of the acquisition date. Changes in fair value resulting from changes in the likelihood or amount of contingent payments can result in charges to P&L in future periods. Previously, contingent consideration payments were recorded only when they became payable.

- Contingencies: "Contractual" contingencies, such as future warranty claims, that are assumed in the acquisition must be recognized at fair value as of closing. The fair value of these contingencies will be "marked-to-market" quarterly and changes in fair value charged to P&L. "Non-contractual" contingencies such as litigation must be recorded at fair value at closing if the possibility of an adverse outcome is "more likely than not." Complicated rules govern whether and how changes in fair value of non-contractual contingents are accounted for in subsequent periods. Previously, a contingency acquired in an acquisition was recorded only if a loss was probable and the amount of the loss was reasonably estimable.

- Valuation of Consideration: The value of stock consideration will be measured as of the closing date. As a result, changes in the value of stock between signing and closing will affect the amount of goodwill recorded in the transaction. This goodwill will then have to be considered for impairment and potentially written down in future periods. Previously, the value of stock consideration was measured as of the agreement date.

- In-process R&D: The fair value of in-process research and development will have to be recognized as of the closing date and amortized. This may result in ongoing P&L charges. Previously, in-process R&D could be written off as of closing.

■ Measurement Period: Acquirers will have up to one year in which to complete accounting for the business combination. If provisional information that is initially recorded is subsequently changed, however, the acquirer will have to recognize these adjustments as of the acquisition date, revise the comparative information for prior periods and provide disclosures about the changes to provisional numbers. Previously, acquirers had a one-year period to complete the accounting, but they did not need to retrospectively adjust previously reported numbers.

■ Equity-based Incentives: If an acquirer issues vested options to holders of the acquiree's unvested options, a portion of the fair value of the new options will be considered compensation expense and recorded in post-closing periods. Previously, the acquirer could include the full value of the new options in the purchase price and not record any compensation expense.

■ Step Transactions: If an acquirer acquires control by more than one transaction over time, the transaction that results in acquisition of control triggers a revaluation of all assets and liabilities of the acquired entity, as well as of any non-controlling interest. Any difference between the fair value at the time of the control acquisition and the previous fair value will be recorded in P&L. Previously, each purchase was accounted for as a separate transaction and no revaluation was required. The new standard also prescribes special rules in other areas, including employee benefit obligations, pre-existing relationships between the acquirer and acquiree and/or selling stockholders, "bargain purchases," and income taxes. In addition, the new standard prescribes expanded disclosure for business combination transactions. The new standard is likely to have significant implications. Among other things, the standard will present difficult valuation issues. It may also contribute to earnings volatility because of possible P&L charges in current and future periods. The requirement for revision of previously reported financial statements based on determinations of values post-closing may lead to more diligence pre-closing to minimize the need for such adjustments. These and other considerations may affect deal structuring. For example, earnouts may become impracticable due to the potential P&L impact of future changes in the valuation of the earnout. Similarly, the terms of stock consideration may have to be structured differently to take account of the uncertainty created by measuring the value of the stock as of closing rather than signing.

B. Trends in Deal Terms

Characteristics of Deals Reviewed		2004	2005	2006	2007
The number of deals we reviewed and the type of consideration paid in each	Sample Size	54	39	53	33
	Cash	43%	69%	68%	48%
	Stock	41%	10%	8%	0%
	Cash and Stock	17%	21%	24%	52%

Deals with Earn-Out		2004	2005	2006	2007
Deals that provided contingent consideration based upon post-closing performance of the target (other than balance sheet adustments)	With Earn-Out	24%	15%	17%	39%
	Without Earn-Out	76%	85%	83%	61%

Deals with Indemnification		2004	2005	2006	2007
Deals where the target's shareholders or the buyer indemnified the other post-closing for breaches of representations, warranties and covenants	With Indemnification				
	By Target's Shareholders	89%	100%	94%	100%
	By Buyer[1]	37%	46%	38%	48%

Survival of Representations and Warranties		2004	2005	2006	2007
Length of time that representations and warranties survived the closing for indemnification purposes[2]	Shortest	6 Months	9 Months	12 Months	6 Months[3]
	Longest	36 Months	24 Months	36 Months	36 Months
	Most Frequent	12 Months	12 Months	12 Months	12 and 18 Months (tie)
Caps on Indemnification Obligations		**2004**	**2005**	**2006**	**2007**
Upper limits on indemnification obligation where representations and warranties survived the closing for indemnification Purposes	With Cap	85%	100%	100%	97%
	Limited to Escrow	72%	79%	84%	78%
	Limited to Purchase Price	7%	5%	2%	9%
	Exceptions to Limits[4]	74%	73%	84%	97%
	Without Cap	15%	0%	0%	3%

[1]The buyer provided indemnification in 48% of the 2004 transactions, 25% of the 2005 transaction, 41% of the 2006 transaction and 53% of the 2007 transaction where buyer stock was used as consideration.
[2]Measured for representations and warranties generally, specified representation and warranties may survive longer.
[3]In two cases representations and warranties did not survive, but in one such case there was indemnity for specified litigation, tax matters and appraisal claims.
[4]Generally, exceptions were for fraud and willful misrepresentation.

VI. NEW PROPOSED PREPARER PENALTY REGULATIONS

The IRS has issued Proposed Regulations under §6694, to assist tax return preparers in avoiding penalties under that provision. So long as tax return preparer has a "reasonable basis" for a return position, the penalty can be avoided through proper disclosure if the position later turns out to be wrong. The Proposed Regulations provide significant detail as to what will constitute proper disclosure. Notably, "boilerplate" language to clients to meet the disclosure requirements will not be acceptable. A quick summary of the Proposed Regulations as to preparers who sign the return, based on how an erroneous reporting issue is characterized, is as follows:

A. There was no "reasonable basis" for the filing position. In this situation, the penalty will almost always apply.

B. There was a "reasonable basis," but not "substantial authority" for the filing position. To avoid a penalty, the preparer must meet disclosure requirements. This will either mean full disclosure to the IRS in accordance with its disclosure rules, or in the case of an income tax return, the preparer delivers the prepared return with proper disclosures to the taxpayer.

C. There was "substantial authority," but no reasonable belief by the preparer that the position was more likely than not reported correctly. Again to avoid a penalty, the preparer must meet disclosure requirements. In this situation for an income tax return, the preparer can meet the disclosure requirements by advising the taxpayer of the applicable penalties and penalty standards.

D. The preparer had a reasonable belief that the reported position was more likely than not reported correctly. In this case, no penalty will apply (with or without disclosure).

E. Misc. Different rules apply for preparers who do not sign the return. Further, the above general rules are subject to various particular refinements in the Proposed Regulations.

VII. THE ELECTION

Issue	Senator McCain (R)	Senator Obama (D)
Federal Budget Priorities	Supports a balanced budget by reducing both taxes and spending. Believes 3/5 majority vote in Congress should be required to raise taxes. Will veto pork-barrel spending & seek line-item veto. Supports one-year spending freeze to evaluate federal programs outside of essential military & veterans programs.	➢ Supports balancing the budget ➢ Investing more in pre-K through higher education, foreign aid, healthcare, social services an the military ➢ Reducing no-bid government contracts & corporate tax breaks

Trade and Investment	Supports reducing U.S. agricultural subsidies and aggressively promoting trade barrier reductions to level the global playing field. Supports the Oman, Colombia, South Korea, Peru, Central and North American Free Trade Agreements. Will consolidate transition assistance and offer education savings accounts for retraining and continuing education.	Rejects reducing U.S. agricultural subsidies, but supports opening foreign markets to U.S. products. Will not sign trade agreements unless they have labor and environmental protections. Supported the Peru free trade agreement, but opposed the Colombian, South Korean, and Central American agreements. Supports amending NAFTA and improving transition assistance.
Taxation	➢ Supports repealing the Alternative Minimum Tax ➢ Retaining cuts for those making $250,000 or more ➢ Keeping the capital gains tax at 15% ➢ Cutting the corporate tax to 25% ➢ Doubling the exemption for dependents ➢ A tax exemption on estate up to $10 million	➢ Supports creating a $1,000/family tax credit to offset payroll taxes ➢ Increasing the Earned Income Tax Credit ➢ Creating a mortgage credit for those who do not itemize deductions ➢ Increasing the capital gains tax ➢ Opposes extending tax cuts for those making over $250,000

MIX IT UP!: A QUICK GUIDE TO MAXIMIZING FDIC INSURANCE COVERAGE

By: Courtney D. Roschek

I. THE FEDERAL DEPOSIT INSURANCE CORPORATION

A. What is the FDIC and how is it funded?

1. The Federal Deposit Insurance Corporation (FDIC) preserves and promotes public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions for at least $100,000; by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails.

2. An independent agency of the federal government, the FDIC was created in 1933 in response to the thousands of bank failures that occurred in the 1920s and early 1930s. Since the start of FDIC insurance on January 1, 1934, no depositor has lost a single cent of <u>insured</u> funds as a result of a failure.

3. The FDIC receives no Congressional appropriations – it is funded by premiums that banks and thrift institutions pay for deposit insurance coverage and from earnings on investments in U.S. Treasury securities. With an insurance fund totaling more than $49 billion, the FDIC insures more than $3 trillion of deposits in U.S. banks and thrifts – deposits in virtually every bank and thrift in the country.

B. FDIC Coverage Basics.

1. The basic FDIC insurance amount is $100K per depositor, per insured bank. Coverage, however, is based on the concept of ownership rights and capacities. Deposits maintained in different

ownership rights and capacities at one bank are separately insured to the insurance limit. Deposits maintained in the same ownership rights and capacities at one bank are added together and insured to the insurance limit. Thus, it is possible to have deposits of more than $100K at one insured bank, in different ownership capacities, and still be fully insured.

2. There are 8 different legal categories recognized by FDIC regulations for coverage beyond the basic $100K amount: single accounts, joint accounts, self-directed retirement accounts, revocable trust accounts, employee benefit plan accounts, corporation/partnership and unincorporated association accounts, and government accounts.

C. Your solution to maximizing FDIC coverage:

1. Mix it up!

2. Maximize your FDIC protection by placing your assets in multiple ownership categories at multiple banks.

II. <u>FDIC DEPOSIT INSURANCE CATEGORIES AND LIMITS</u>

A. Single accounts (12 C.F.R. § 330.6)(added together with a total insured limit of $100K).

1. Single accounts are accounts that are:

a. In one person's name alone;

b. Established for one person by an agent, nominee, guardian etc.;

c. Held in the name of a sole proprietorship; or

d. Established for a decedent's estate.

2. The default category: Any account that fails to qualify under another ownership category defaults to a single account.

EXAMPLE: Napoleon Jones has four single accounts at the same bank. Three accounts are held in his name alone (3 accounts @ $35,000.00) and one account held by his business, which is a sole proprietorship (also considered a single account) (1 account @ $45,000.00).

Total of all single accounts in Napoleon's name:	$150,000.00
FDIC deposit insurance limit:	$100,000.00.
Uninsured amount:	**$50,000**

B. Self-directed retirement accounts (12 C.F.R. § 330.14(c)(2)): (owned by one person, titled in the name of that person's retirement account) added together and the total is insured up to $250K.

1. These accounts include:

a. All IRAs (Traditional, Roth, SEPs, SIMPLE);

b. §457 deferred compensation plan accounts;

c. Self directed defined contribution plan accounts (401Ks, SIMPLES, money purchase plans, profit sharing plans); and

d, Self directed Keogh plan (403(b)) accounts.

2. Note:

a. "Self directed" means plan participants have the right to direct how the account is invested.

b. Naming beneficiaries does not increase coverage.

EXAMPLE: Bob Johnson has a Roth IRA in the amount of $110,000 and a traditional IRA in the amount of $75,000 with one bank. Since Bob's total in all self-directed retirement accounts at the same bank is less than the $250,000.00 insurance limit, his IRA deposits are fully insured.

Total of all self-directed accounts in Bob's name:	$185,000.00
FDIC deposit insurance limit:	$250,000.00.
Uninsured amount:	**$0**

C. Joint accounts (owned by 2 or more people) (12 C.F.R. § 330.7).

1. Requires the following three (3) items for $100K coverage per co-owner (each co-owner's share of every account that is jointly held at the same insured bank is added together with the co-owner's other shares, and the total is insured up to the limit):

a. All co-owners must be people;

b. With equal rights to withdrawal; and

c. All co-owner must sign signature card (unless it's a CD).

2. EXAMPLE:

Account Title	Deposit Type	Balance
Peter and Sue Smith	CD 1	$200,000.00
Sue and Pam Smith	CD 2	$200,000.00
	Total	$400,000.00

Depositors	Ownership Share	Insured Amount	Uninsured Amount
Peter Smith	$100,000.00	$100,000.00	$0
Sue Smith	$200,000.00	$100,000.00	$100,000.00
Pam Smith	$100,000.00	$100,000.00	$0

- Peter's ownership share in all joint accounts equals ½ of CD 1 ($100,000) so his share is fully insured.

- Sue's ownership share in all joint accounts equals ½ of CD 1 ($100,000) and ½ of CD 2 ($100,000). Her total share of all joint accounts is $200,000, of which $100,000 is insured and $100,000 is uninsured.

- Pam's ownership share in all joint accounts equals ½ of CD 2 ($100,000) so her share is fully insured.

D. Revocable Trust Accounts (12 C.F.R. § 330.10).

1. POD accounts are insured up to $100K per qualifying beneficiary (in addition to the insurance coverage of owners) if the following requirements are met:

a. Title of account must include commonly accepted terms (POD, ITF, ATF);

b. Beneficiaries must be identified by name in the deposit account records; and

c. Beneficiaries must be "qualifying" (spouse, child, grandchild, parent, siblings).

2. Living/Family Trust Accounts are insured up to $100K per owner (grantor) for each named qualifying beneficiary and the following is met:

a. Title of account must include "living trust" or "family trust;" and

b. Beneficiaries must be qualifying.

c. NOTE: while similar to POD insurance, these types of trusts often have multiple beneficiaries with varying trust interests and accordingly extensive requirements for maximum coverage. Some key facts include:

i. Coverage is based upon the interests of qualifying beneficiaries who would become entitled to receive trust assets when the last trust owner dies;

ii. If a beneficiary has a life estate in the trust assets; (Family Trust, QTIP Trust) with other beneficiaries receiving the remaining assets after the first beneficiary dies—the FDIC will recognize all beneficiaries in determining coverage;

iii. If a trust has multiple owners—coverage will be up to $100K per qualifying beneficiary for each owner, provided that the beneficiaries are entitled to receive trust assets when last owner dies; and

(a) i.e. Husband (H) and Wife (W) co-owners of a living trust where upon death of H or W the trust passes to the survivor, and upon the death of the last owner, the assets pass to their 3 children equally—

(b) Thus, living trust is insured up to $600K.

iv. If any of the above requirements are not met—account only insured up to the default or $100K.

EXAMPLE: A living trust names an owner's three children as beneficiaries but states that each beneficiary's share will pass to the beneficiary's children (the owner's grandchildren) if the beneficiary dies before the owner. Assuming all three children are alive at the time the bank fails, only the children - not the grandchildren- will be considered beneficiaries for insurance purposes (the grandchildren are not entitled to any trust assets while their parent is alive). Coverage up to $300,000 ($100,000 per beneficiary) will be available on the trust's deposit accounts.

EXAMPLE: Mary Thompson has a living trust with a balance of $400,000. The trust states that upon her death her husband, Frank, will receive distributions during his lifetime (a life estate interest) and when he dies, the remaining funds are distributed to their three children in shares of 20%, 30% and 50%:

- Step 1: Determine the percentage interest of the life estate beneficiary. (Since there are four beneficiaries, Frank is entitled to 25%.)
- Step 2: Determine the life estate beneficiary's share of the deposits. Total deposits ($400,000) times the life estate beneficiary's Interest (25%) = $100,000
- Step 3: Subtract the life estate beneficiary's dollar interest in Step 2 from the total deposits ($400,000 less $100,000 = $300,000)
- Step 4: Allocate the remaining deposits ($300,000) based on the percentage Interests of the remainder beneficiaries (the children):
    - Nancy's Interest = $60,000 ($300,000 X 20%)
    - Karen's Interest = $90,000 ($300,000 X 30%)
    - Larry's Interest = $150,000 ($300,000 X 50%)
- The <u>total</u> amount insured in this example is $350,000.

E. Irrevocable Trust Accounts (12 C.F.R. § 330.13).

1. Generally: the interests of a beneficiary in all deposit accounts, established by the same grantor, and held at the same insured bank under an irrevocable trust are added together and insured up to the $100K, only if all of the following requirements are met:

    a. Insured bank's account records must disclose the existence of the trust relationship;

b. The beneficiaries and their interests in the trust must be identifiable from the bank's account records or from the trustee's records;

c. The amount of each beneficiary's interest must not be contingent; and

d. Trust must be valid under state law.

2. Note:

a. Beneficiary does not need to be related to the grantor to obtain insurance coverage.

b. If grantor retains interest in the trust, the amount will be added to single accounts owned by grantor at the same bank—with a total of $100K insured.

c. Irrevocable trusts are not insured per beneficiary when the trust agreement:

i. Does not name or provide means of identification of the beneficiaries;

ii. Puts conditions on the receipt of assets for certain beneficiaries;

iii. Provides that trustee may invade the trust corpus, reducing assets available to remaining beneficiaries; and

iv. Provides the trustee or beneficiary with the discretion in the distribution of trust assets.

F. Employee Benefit Plan Accounts (12 CFR 330.14)

1. Insured up to $100K for each participant's non-contingent (presumably the vested account balance) interest in the plan—coverage is not based on number of participants, but rather each participant's share of the plan.

EXAMPLE: The MHWRH, PC Employee Benefit Plan has a $400,000.00 balance.

Plan Participants	Plan Share	Ownership Share	Insured Amount	Uninsured Amount
Mr. Maddin	40%	$160,000	$100,000	$60,000
Mr. Hauser	35%	$140,000	$100,000	$40,000
Ms. Paralegal	15%	$60,000	$60,000	0
Mr. Secretary	10%	$40,000	$40,000	0

The maximum amount of Insurance coverage a plan can deposit at one bank and still be fully insured is determined by ensuring that the employee with the largest percentage interest in the plan deposits does not exceed $100,000. In this example, if the employee benefit plan has deposited $200,000 in one bank, the deposit results in Mr. Maddin's interest (the largest participant) being insured for $100,000 (40% of $250,000). When Mr. Maddin's interest is fully insured, the rest of the deposit will be insured, since the other interests are smaller.

G. Corporation/Partnership/Unincorporated Association Accounts (12 C.F.R. § 330.11): deposits owned by the entity are insured up to $100K at a single bank, but are insured separately from the personal accounts of the entity's stockholders, partners, or members.

1. NOTE:

a. To qualify for coverage under this category the entity must be engaged in "independent activity" (i.e. operated primarily for some purpose other than to increase insurance coverage).

b. Number of partners/members/associates does not matter—entity account gets $100K

2. EXAMPLE: The president of a corporation has a personal joint account with her husband at the same bank where her corporation's funds are deposited. The president is an authorized signatory on the corporate account. The joint account with her husband is insured up to $200,000 and the corporation's deposits are separately insured up to $100,000.

H. Government Accounts (12 C.F.R. § 330.15): also known as public unit accounts. This category includes deposit accounts of:

1. The United States,

2. Any state, county, municipality (or a political subdivision of any state, county, or municipality), the District of Columbia, Puerto Rico and other government possessions and territories), and

3. An Indian Tribe.

III. <u>QUICK RESOURCES AND CONTACTS</u>

A. FDIC Coverage Calculator: Edie the Estimator will help you estimate your clients FDIC coverage:

http://www.fdic.gov/edie/index.html

B. Determine if your clients bank is FDIC insured:

http://www2.fdic.gov/idasp/main_bankfind.asp

C. FDIC Employee's guide to FDIC coverage: User friendly resource with practical examples:

http://www.fdic.gov/deposit/deposits/financial/index.html

D. FDIC guide to revocable/irrevocable trusts:

http://www.fdic.gov/deposit/deposits/di_trust_accounts/index.html

E. FDIC Information Specialists: 1-877-ASK-FDIC

1. Shortcut: After initial prompts press "0" and ask to speak to an "FDIC Deposit Insurance Subject Matter Specialist"

a. This shortcut will connect you with an FDIC research attorney and circumvent the first-level operators.

IV. OTHER THINGS TO BE AWARE OF

A. Securities Investor Protection Corporation (the SIPC).

1. What is it?

a. Though created by the Securities Investor Protection Act (15 U.S.C. §78aaa et seq., as amended), SIPC is neither a government agency nor a regulatory authority.

b. SPIC is a nonprofit, membership corporation, funded by its member securities broker-dealers.

2. How the SIPC differs from the FDIC.

a. The SIPC is not the securities world equivalent of FDIC. Congress specifically considered creating a Federal Broker-Dealer Insurance Corporation, but lawmakers concluded that such a designation would be both misleading and out of step in the risk-based investment marketplace that is so different from the world of banking.

b. When a member back fails, the FDIC insures all depositors at the institution against loss up to a certain dollar amount. The SPIC, on the other hand, does not bail out investors when the value of their stocks, bonds, and other investments fail for any reason. Instead the SIPC replaces missing stocks and other when possible to do so as a result of theft by a broker or other risk related to brokerage failing.

3. What assets are eligible for SIPC coverage?

   a. Eligible for coverage: cash and securities – such as stocks and bonds – held by a customer at a financially troubled brokerage firm.

   b. Ineligible for coverage: commodity futures contracts and currency, as well as investment contracts (such as limited partnerships) and fixed annuity contracts that are not registered with the U.S. Securities and Exchange Commission under the Securities Act of 1933.

4. SIPC coverage basics:

   a. SIPC does not cover individuals who are sold worthless stocks—the SIPC helps individuals whose money, stocks, and other securities are stolen by a broker or put at risk when a brokerage firm fails for other reasons.

   b. SIPC will replace up to $500,000.00 of equities, fixed-income securities and funds for each account. Included in the $500,000.00 is coverage for up to $100,000.00 in cash.

   c. Note: the SIPC replaces shares and <u>not</u> dollar values. Thus, if you own 100 shares of Flobee stock worth $3,000.00 and your broker runs off with them, SIPC replaces your 100 shares—even if they are only worth $1,500.00.

   d. For more information: www.sipc.org

B. Certificate of Deposit Account Registry Service (CDARS).

1. With CDARS, banks can offer up to $50 million in FDIC coverage by having one institution place your funds into certificates of deposit issued by banks in the CDARS network in increments of less than $100,000 to ensure that both principal and interest are eligible for full FDIC Insurance.

2. How it works. An example.

a. Seymour Smith has $600,000.00 deposited at Bank A (a bank that is a CDARS participant).

b. Bank A separates Seymour Smith's funds into 11 different CD's: 6 @ $90,0000.00 and 1 @ $60,000.00.

c. Each CD is held at a different CDARS participating bank→ thus the principal and interest of all CD's will be under the FDIC general rule for coverage: $100,000.00 insured per ownership category, per insured bank.

3. For more information: www.cdars.com

a. Participating Michigan banks:

http://www.cdars.com/find-cdars.php

b. Other benefits of CDARS:

http://www.cdars.com/why-cdars.php

V. UPDATES!

A. The Emergency Economic Stabilization Act of 2008.

1. On October 3, 2008, President George W. Bush signed the Emergency Economic Stabilization Act of 2008, which temporarily

raises the basic limit on federal deposit insurance coverage from **$100,000 to $250,000** per depositor. The temporary increase in deposit insurance coverage became effective upon the President's signature. The legislation provides that the basic deposit insurance limit will return to $100,000 after December 31, 2009.

2. By letter dated October 3, 2008 (Financial Institution Letter 102-2008), the FDIC advised insured institutions they should inform depositors that the coverage increase is temporary and effective only until December 31, 2009. The legislation did not increase coverage for retirement accounts; it continues to be $250,000.

B. Bank Rating Systems.

1. Many private companies' bank rating systems are recommended (but not endorsed) by the FDIC.

2. The best, free, user-friendly ratings can be found at:

   a. http://www.thestreet.com/screener/index.html

   b. http://www.bankrate.com/brm/safesound/select.asp?insttype=0

3. For more detailed information about the financial market and bank stability you can also utilize century-old market analyst Standard & Poor's:

   a. www.standardandpoors.com ; or

   b. contact S&P's research division 212-438-7280 (option #2 at prompting)